90-645

(1)

No. _____

FILED
OCT 29 1990
JOSEPH F. SPANIOL, JR.
CLERK

In The

Supreme Court of the United States

October Term, 1990

Norwest Bank Duluth, N.A.,
Petitioner,

v.

Minnesota Commissioner of Revenue
and the State of Minnesota,
Respondents.

Cambridge State Bank, et al.,
Petitioners,

v.

Minnesota Commissioner of Revenue,
Respondent.

On Petition for Writ of Certiorari to the Minnesota Supreme Court

---

PETITION FOR WRIT OF CERTIORARI

Robert L. Schnell, Jr.*
Walter A. Pickhardt
Patrick J. Schiltz
FAEGRE & BENSON
2200 Norwest Center
90 South Seventh Street
Minneapolis, Minnsota 55402-3901
(612) 336-3000

Christopher J. Dietzen
Andrew J. Mitchell
LARKIN, HOFFMAN, DALY
& LINDGREN
1500 Northwestern Financial
Center
Minneapolis, Minnesota 55431
(612) 835-3800

Laurance R. Waldoch
James P. McCarthy
LINDQUIST & VENNUM
4200 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
(612) 371-3211

Attorneys for Petitioners

*Counsel of Record

1990-EXECUTEAM / LAW DIV., 93 W. Little Canada Rd., St. Paul, MN 55117 • 612/483-8793 • 800/747-8793

QUESTIONS PRESENTED

The State of Minnesota imposed a bank excise tax on net income, including interest on obligations of the United States ("federal obligations") but excluding interest on certain state and local obligations ("state obligations"). The Minnesota Supreme Court held the tax to be unlawfully discriminatory under 31 U.S.C. § 742, but refused to order a refund of taxes paid by Petitioners on federal obligation interest despite their compliance with state refund procedures. The questions presented are:

1. Whether a state court can require as a condition to bringing an action under 31 U.S.C. § 742 that a taxpayer pay a judicially imposed tax on state obligation interest that is exempt under state statutory law, where the tax is not imposed on any person not bringing an action under 31 U.S.C. § 742.

2. Whether a state court can deny refunds of a state tax that unlawfully discriminated against federal obligations by retroactively revoking the exemptions for state obligations and imposing a tax on state obligation interest. If so, whether a state court may deny such refunds:

   a. When it does not order the tax to be collected; or

   b. When it cannot order the tax to be collected because of an eleven-year interval between the year of the exemption and the state court's decision.

3. Whether a state court can refuse to apply the nondiscrimination rule of 31 U.S.C. § 742 through the purported prospective-only application of this Court's decision in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983).

LIST OF PARTIES AND RULE 29.1 STATEMENT

The parties to the proceedings in the Minnesota Supreme Court were: (1) Petitioners Norwest Bank Duluth, N.A. ("Norwest"), Cambridge State Bank ("Cambridge"), First Security State Bank of Sleepy Eye ("First Security") and Midway National Bank of St. Paul ("Midway"), and (2) Respondents Arthur C. Roemer, Commissioner, Minnesota Department of Revenue, and the State of Minnesota. The current Minnesota Commissioner of Revenue is John P. James.

The following is a Rule 29.1 listing of parent companies of the Petitioners and subsidiaries of the Petitioners other than wholly-owned subsidiaries.

Norwest Bank Duluth, N.A.

Norwest Corporation

Cambridge State Bank

None

First Security State Bank of Sleepy Eye

First Sleepy Eye Bancorp

Midway National Bank of St. Paul

None

TABLE OF CONTENTS

PAGE

Questions Presented i

List of Parties and Rule 29.1 Statement ii

Table of Authorities v

Opinions Below 2

Jurisdiction 2

Constitutional and Statutory Provisions Involved 2

Statement of the Case 3

Reasons for Granting the Writ 7

I. The Minnesota Supreme Court's Decision Undermines the Doctrine of Intergovernmental Immunity By Denying Refunds of a Discriminatory Tax 9

II. The Minnesota Supreme Court's Holding That Petitioners Were Estopped from Challenging the Discriminatory Tax Denies Due Process and Results in Further Discrimination Against Holders of Federal Obligations 12

III. The Minnesota Supreme Court's Holding that Discrimination Could Be Cured by Imposing a Fictitious Tax on State Obligation Interest Is in Conflict with *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco* and Other Decisions of This Court 15

IV. The Minnesota Supreme Court's Holding Applying *Memphis Bank & Trust Co. v. Garner* Prospectively Only Is in Conflict with This Court's Decisions in *American Trucking Ass'ns, Inc. v. Smith* and *Ashland Oil, Inc. v. Caryl* 18

Conclusion 23

Appendix 1A

Opinion of the Minnesota Supreme Court 1A

Decision of the Ramsey County District Court (Phase I) 16A

Decision of the Ramsey County District Court (Phase II) 30A

Judgment of the Minnesota Supreme Court 47A

Relevant Minnesota Statutes 48A

TABLE OF AUTHORITIES

PAGE

Cases

Allegheny Pittsburgh Coal Co. v. County Comm'n, 109 S. Ct. 633 (1989) 8, 15, 16

American Trucking Associations, Inc. v. Smith, 110 S. Ct. 2323 (1990) 9, 18, 19, 21

Ashland Oil, Inc. v. Caryl, 110 S. Ct. 3202 (1990) 9, 18, 19, 20

Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) 9

Bass v. South Carolina, No. 23216 (S.C. Sup. Ct. Aug. 6, 1990) (1990 S.C. LEXIS 164) 12

Bohn v. Waddell, No. TX 89-00050 (Ariz. Bd. Tax App. Apr. 6, 1990)(1990 Ariz. Tax LEXIS 8) 12

Carpenter v. Shaw, 280 U.S. 363 (1930) 8

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) 19, 21

Davis v. Michigan Dept. of Treasury, 109 S.Ct. 1500 (1989) 10, 11, 12

First of McAlester Corp. v. Oklahoma Tax Comm'n, 709 P.2d 1026 (Okla. 1985) 19

Florida v. Long, 487 U.S. 223 (1988), *reh'g denied* 487 U.S. 1263 (1988) 20

Iowa-Des Moines National Bank v. Bennett, 284 U.S. 239 (1931) 8, 16

James B. Beam Distilling Co. v. State, 259 Ga. 363, 382 S.E.2d 95 (1989), *cert. granted*, 110 S.Ct 2616 (1990) 9

Kadrmas v. Dickinson Public Schools, 487 U.S. 450 (1988) 13, 14

Lawrence v. State Tax Comm'n, 286 U.S. 276 (1932) 13

M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) 7, 10, 20

McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 110 S. Ct. 2238 (1990) ..... passim

Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983) ..... passim

Montana Nat'l Bank v. Yellowstone County, 276 U.S. 499 (1928) 8, 16, 17

Moses Lake Homes, Inc. v. Grant County, 365 U.S. 744, *reh'g denied*, 366 U.S. 947 (1961) 10, 18

National Mines Corp. v. Caryl, 110 S. Ct. 3205 (1990) 9

Phillips Chemical Co. v. Dumas Indep. School Dist., 361 U.S. 376 (1960), *reh'g denied*, 362 U.S. 937 (1960) 10, 18

Schuylkill Trust Co. v. Pennsylvania, 296 U.S. 113 (1935) 7, 13, 20

Sioux City Bridge Co. v. Dakota County, 260 U.S. 441 (1923) 8

South Carolina v. Baker, 485 U.S. 505 (1988) 10

State v. Duluth, M. & N. Ry. Co., 207 Minn. 618, 292 N.W. 401 (1939), *reh'g denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940) 7, 20

United States v. Darusmont, 449 U.S. 292 (1981) 17

Ward v. Board of County Comm'rs, 253 U.S. 17 (1920) 8

Welch v. Henry, 305 U.S. 134 (1938) 17

Statutes and Constitutional Provisions

PAGE

4 U.S.C. § 111 11

28 U.S.C. § 1341 8

31 U.S.C. § 742 . . . . . passim

31 U.S.C. § 3124(a) 3

Act of September 22, 1959, Pub. L. No. 86-346, § 105(a), 73 Stat. 621, 622 22

Minn. Stat. § 136.32 (1978) 13

Minn. Stat. § 290.08, Subd. 13 (1978) 14

Statutes and Constitutional Provisions
continued

Minn. Stat. § 290.361 (1978) 3

Minn. Stat. § 290.49, Subd. 1 (1988) 18

Minn. Stat. § 290.50 (1982 and Supp. 1983) 4

Minn. Stat. § 474.12 (Supp. 1979) 13

Rev. Stat. § 3701 2

Rev. Stat. § 5219 16

The United States Constitution,
amendment XIV, § 1 3

The United States Constitution,
article I, § 8, cl. 2 3

The United States Constitution,
article VI, cl. 2 3

Other Authorities

PAGE

Douglas, *State Tax and Budget Actions*, Tax
Notes, July 30, 1990 12

Eckl, Felde, Wolfe & Zimmerman, *State
Taxation of Public Pensions: The Impact of
Davis v. Michigan*, Tax Notes, May 28, 1990 12

Tax News, Iowa Department of Revenue
(August 1990) 12

No. ____

In The
Supreme Court of the United States

October Term, 1990

Norwest Bank Duluth, N.A.,

Petitioner,

v.

Minnesota Commissioner of Revenue
and the State of Minnesota,

Respondents.

Cambridge State Bank, et al.,

Petitioners,

v.

Minnesota Commissioner of Revenue,

Respondent.

On Petition for Writ of Certiorari To
The Minnesota Supreme Court

PETITION FOR WRIT OF CERTIORARI

The Petitioners respectfully ask that a writ of certiorari issue to review the judgment of the Minnesota Supreme Court entered in the above-entitled proceeding.

OPINIONS BELOW

The opinion of the Minnesota Supreme Court (Yetka, J.) is reported at 457 N.W.2d 716, and is reprinted in the appendix hereto at App. 1A. The Minnesota Supreme Court affirmed in part and reversed in part unreported decisions of the Ramsey County District Court (the Honorable Harold Schultz) rendered in bifurcated proceedings. The district court's decisions in Phases I and II of the trial are reprinted in the appendix hereto at App. 16A and App. 30A respectively.

JURISDICTION

The judgment of the Minnesota Supreme Court was entered on August 28, 1990, and is reprinted in the appendix hereto at App. 47A. Jurisdiction to review that judgment by writ of certiorari is conferred upon this Court by 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

During the 1979 tax year at issue, Rev. Stat. § 3701, then codified at 31 U.S.C. § 742, provided as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either

> the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

This statute is now codified, with minor amendments not affecting a substantive change in the law, at 31 U.S.C. § 3124(a).

The United States Constitution, article I, § 8, cl. 2 (the "Borrowing Clause"), provides that Congress has power "[t]o borrow money on the credit of the United States."

The United States Constitution, article VI, cl. 2 (the "Supremacy Clause"), provides in relevant part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The United States Constitution, amendment XIV, § 1 (the "Due Process Clause"), provides in relevant part:

> . . . nor shall any State deprive any person of . . . property, without due process of law; . . .

The full text of the relevant Minnesota statutes is set forth in the appendix hereto at App. 48A-53A.

STATEMENT OF THE CASE

During 1979, Minnesota imposed an excise tax on banks measured by net income. Minn. Stat. § 290.361 (1978). Interest on

federal obligations was taxable while interest on certain state obligations was exempt. Petitioners, who were subject to the bank excise tax, paid tax on federal obligation interest for 1979. Thereafter, they timely filed claims for refund of taxes paid with respect to federal obligation interest. (App. 20A.) Petitioners asserted as a basis for their claims that the Minnesota bank excise tax was discriminatory in violation of 31 U.S.C. § 742 and the intergovernmental immunity doctrine. In support of their claims, they cited *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which held a nearly identical Tennessee tax to be discriminatory against federal obligations and violative of 31 U.S.C. § 742 and the intergovernmental immunity doctrine. After the expiration of a six-month period during which the Minnesota Commissioner of Revenue (the "Commissioner") failed to act upon their claims, Petitioners timely filed refund actions in Ramsey County District Court against the Commissioner and the State of Minnesota.[1] (App. 20A.)

The parties stipulated in the trial court that in 1979 federal obligation interest was taxable while state obligation interest was exempt. Respondents took the position that the bank excise tax, despite its facial discrimination, was nonetheless lawful on the theory

---

[1] Petitioners followed the procedures set forth in Minn. Stat. § 290.50 (1982 and Supp. 1983) (App. 50A) in filing claims for refund of taxes paid "in excess of the amount legally due" and filing refund actions in state district court. Petitioner Norwest filed suit for the 1979 year only. Petitioners Cambridge, First Security and Midway, together with approximately 200 other banks, filed suit for the years 1979 through 1983 in a separate action, which was consolidated with the Norwest suit by the district court. By agreement of counsel and order of the district court, Petitioners Cambridge, First Security and Midway were selected as "test banks" from among the numerous plaintiffs in the case, and 1979 was selected as the "test year." Judgment was entered as to the test banks for the 1979 test year in accordance with Minnesota Rules of Civil Procedure, Rule 54.02, which permits final judgment with respect to fewer than all of the claims or parties when there is no just reason for delay. In briefs filed below, the Commissioner has asserted that approximately 700 banks in Minnesota have claims similar to those here at issue.

that harm to the Federal Government was only *de minimis*. The trial court determined on the basis of expert economic testimony that there would be an annual increase in federal borrowing costs of $1.75 billion if all states adopted discriminatory bank excise taxes similar to the Minnesota tax. (App. 25A.) The court concluded that this impact was "far from *de minimis*," (App. 26A), and held that the bank excise tax unlawfully discriminated against federal obligations in violation of 31 U.S.C. § 742 and the United States Constitution. (App. 21A.) This holding and the rejection of the *de minimis* argument were affirmed on appeal by the Minnesota Supreme Court. (App. 6A-8A.)

While both the trial court and the Minnesota Supreme Court agreed that the bank excise tax discriminated against federal obligations, they disagreed on whether Petitioners were entitled to refunds. The trial court awarded refunds of taxes paid "in excess of the amount legally due" under the state refund statute in the following amounts: Norwest, $189,065; First Security, $36,278; Cambridge, $23,833; and Midway, $46,574. (App. 42A-43A.) The Minnesota Supreme Court reversed, holding that refunds should be denied on grounds that are the subject of this petition, as set forth below.

1. **Estoppel.** Respondents argued in both the trial court and the Minnesota Supreme Court that Petitioners were estopped under the acceptance-of-benefits doctrine from challenging discrimination against federal obligations because Petitioners, who owned exempt state obligations as well as taxable federal obligations, did not pay a tax on exempt state obligation interest. Petitioners responded that they could not be required to make a contribution to the State of taxes they did not owe (i.e., taxes on exempt state obligation interest) as a precondition to challenging discrimination against federal obligations. The trial court agreed. (App. 25A-26A.) The Minnesota Supreme Court reversed, holding that Petitioners were estopped from challenging the discriminatory tax. (App. 8A.)

2. **Revocation of State Obligation Exemptions.** Respondents contended in both the trial court and the Minnesota Supreme Court that discrimination could (and should) be cured by revoking the exemptions for state obligations. They asked the court to impose a retroactive tax on state obligation interest in order to equalize the treatment of state and federal obligations. Respondents stipulated, however, that the State had not and would not collect such a tax. (App. 33A.) Petitioners argued that a fictional tax that would not and could not be collected would not cure the actual discrimination that existed in 1979.[2] The trial court agreed, holding that a fictional retroactive tax on state obligation interest "would, in substance and effect, uphold the unconstitutional discrimination against the federal obligations and deny [Petitioners] a remedy." (App. 33A.)

The Minnesota Supreme Court reversed. Purporting to distinguish this Court's decision last Term in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990), which rejected a similar fictional tax argument, the Minnesota Supreme Court held that discrimination would be cured by a fictional tax on state obligation interest that did not have to be collected. (App. 11A.) The court also stated that it would have ordered Respondents to assess and collect the tax on state obligation interest -- notwithstanding Respondents' stipulation to the contrary and notwithstanding that the tax would be retroactive for a period of eleven years -- but said that it was not necessary to do so in light of the court's ruling that *Memphis Bank* could be applied prospecti-

---

[2] Prior to Respondents' stipulation that the tax on state obligation interest *would* not be collected, Petitioners also contended that a retroactive tax on state obligation interest *could* not be collected because (1) a tax on state obligation interest retroactive to the 1979 year at issue could not be imposed without violating the Due Process Clause, and (2) the statute of limitations would prevent collection of the tax from virtually all taxpayers. Petitioners also argued that, even if it were possible to impose and collect the tax, such action would not undo the discriminatory impact on federal borrowing costs in 1979.

vely only. (App. 11A-12A.)

3. **Prospective-Only Application of Memphis Bank.** Respondents contended in the trial court and the Minnesota Supreme Court that the bank excise tax should be treated as lawful for 1979, notwithstanding discrimination against federal obligations, through prospective-only application of the 1983 *Memphis Bank* decision. In response, Petitioners argued that prospectivity analysis was irrelevant because, even if prospective-only application were given to *Memphis Bank*, the bank excise tax would still have been unlawfully discriminatory under *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935), and *State v. Duluth, M. & N. Ry. Co.*, 207 Minn. 618, 624-28, 292 N.W. 401, 405-06 (1939), *reh'g denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940), both of which firmly established long before 1979 that a state tax is unconstitutional if it discriminates against holders of federal obligations. Petitioners also argued that, if it were necessary to reach the prospectivity issue, *Memphis Bank* had to be applied retroactively. The trial court held for the Petitioners on these issues. (App. 40A.) The Minnesota Supreme Court reversed. Without discussion of or even citation to *Schuylkill Trust* or *Duluth M. & N. Ry.*, the court applied *Memphis Bank* prospectively only.[3] (App. 12A-14A.)

REASONS FOR GRANTING THE WRIT

Since *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), this Court has prohibited states from imposing taxes that discrimi-

---

[3] The three questions presented for review were argued by the parties in cross motions for summary judgment and *in limine* before the trial court. The trial court granted partial summary judgment for Petitioners that revocation of state obligation exemptions would not cure discrimination. (App. 32A-33A.) All motions pertaining to estoppel (App. 18A) and prospectivity (App. 33A) were denied. The trial court held for Petitioners on estoppel and prospectivity subsequent to trial.

nate against the Federal Government or those with whom it deals. Congress reaffirmed this principle in 1959 when it amended 31 U.S.C. § 742 to prohibit states from imposing discriminatory corporate franchise taxes on federal obligation interest. This Court in *Memphis Bank* unanimously held that the 1959 amendment was "principally a restatement of the constitutional rule" prohibiting discrimination, 459 U.S. at 397-99, and struck down a discriminatory bank excise tax nearly identical to the Minnesota bank excise tax here at issue.

The Minnesota Supreme Court conceded that the Minnesota bank excise tax was discriminatory in 1979 (App. 6A), but held that the State did not have to refund the unlawful tax despite full compliance by Petitioners with state refund procedures. The court justified its decision by noting that refunds would "cause a hardship to the State of Minnesota" and result in "an undeserved windfall" to Petitioners. (App. 13A-14A.)

The Tax Injunction Act, 28 U.S.C. § 1341, requires taxpayers subjected to unlawful taxation to seek redress in the state courts, even in cases involving violations of federal rights. It is unfortunately the case that some state courts, out of a concern for the state fisc, have been all too willing to excuse violations of federal rights by denying taxpayers meaningful relief in the form of refunds. This Court has reviewed a number of similar cases over the years, and has repeatedly and consistently granted certiorari to reverse such decisions.[4]

Just last Term, this Court decided four cases concerning the obligation of a state to provide refunds of unconstitutional taxes.

---

[4] *See, e.g., Allegheny Pittsburgh Coal Co. v. County Comm'n*, 109 S. Ct. 633, 638-39 (1989); *Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931); *Carpenter v. Shaw*, 280 U.S. 363, 369 (1930); *Montana Nat'l Bank v. Yellowstone County*, 276 U.S. 499, 504-05 (1928); *Sioux City Bridge Co. v. Dakota County*, 260 U.S. 441, 446-447 (1923); *and Ward v. Board of County Comm'rs*, 253 U.S. 17, 24 (1920).

See McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 110 S. Ct. 2238 (1990); *American Trucking Ass'ns, Inc. v. Smith*, 110 S. Ct. 2323 (1990); *Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202 (1990); *and National Mines Corp. v. Caryl*, 110 S. Ct. 3205 (1990). Collectively, these cases make it clear that a state *must* refund a tax that is "beyond the State's power to impose." *McKesson*, 110 S. Ct. at 2251. The Minnesota Supreme Court held that this principle had no application to violations of 31 U.S.C. § 742 and the doctrine of intergovernmental immunity, since each of the cases decided last Term involved the Commerce Clause.[5]

Petitioners ask that this Court grant certiorari to reverse. The *McKesson* rule ought to apply with even greater force in cases like the instant case, since the purpose of 31 U.S.C. § 742 and the doctrine of intergovernmental immunity is to protect Federal Government operations against the state and local pressures to which the Minnesota Supreme Court yielded in this case. This Court should make it unmistakably clear to the state courts that the remedial jurisprudence fashioned in the Commerce Clause context applies *a fortiori* where Congress has passed legislation to protect the Federal Government. The Court has never tolerated the denial of a remedy for a constitutional wrong, and should not do so here. If there be any doubt as to the need for certiorari, Petitioners request that the Court seek the views of the Solicitor General of the United States because of the paramount federal interest involved.

---

[5] The Court also granted certiorari last Term in *James B. Beam Distilling Co. v. State*, 259 Ga. 363, 382 S.E.2d 95 (1989), *cert. granted*, 110 S. Ct. 2616 (1990). *Beam Distilling* raises the issue of whether *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), should be applied on a prospective-only basis. Like *McKesson*, *American Trucking*, *Ashland Oil* and *National Mines*, *Beam Distilling* is a Commerce Clause case.

I. The Minnesota Supreme Court's Decision Undermines the Doctrine of Intergovernmental Immunity by Denying Refunds of a Discriminatory Tax.

The decision of the Minnesota Supreme Court denying refunds to Petitioners undermines the rule of *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), that "a state tax may not discriminate against the Government or those with whom it deals." *Phillips Chemical Co. v. Dumas Indep. School Dist.*, 361 U.S. 376, 387 (1960), *reh'g denied*, 362 U.S. 937 (1960). If allowed to stand, the court's several grounds for refusing to provide a remedy for a constitutional wrong would soon destroy private actions to enforce intergovernmental immunity doctrine rights since the state courts, which historically have been reluctant to protect such rights, could always: (1) estop persons dealing with the Federal Government from challenging discriminatory taxes unless they first pay a sort of "poll" tax on otherwise exempt income for the privilege of making the challenge; (2) "cure" discrimination by ordering retroactive imposition (but not collection) of fictional taxes on previously exempt income that in theory -- but not in fact -- equalize tax burdens; and (3) refuse to follow decisions of this Court under the pretext of prospective decisionmaking.

The doctrine of intergovernmental immunity "is based on the need to protect each sovereign's governmental operations from undue interference by the other." *Davis v. Michigan Dept. of Treasury*, 109 S. Ct. 1500, 1507 (1989). The principle of nondiscrimination, which is "at the heart" of the immunity doctrine, "recognizes that the best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion." *South Carolina v. Baker*, 485 U.S. 505, 525, n.15 (1988). "If anything is settled in the law, it is that a State may not discriminate against the Federal Government . . .." *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 751, *reh'g denied*, 366 U.S. 947 (1961).

While the purpose of the immunity doctrine is to protect the

Federal Government, it is well settled that individuals and private entities who are subjected to discriminatory taxation on account of their dealings with the Federal Government are also entitled to constitutional protection. *Davis*, 109 S. Ct. at 1506-07. Allowing such persons to challenge discriminatory taxes serves to protect the Federal Government since the economic burden of such taxes is borne by the Federal Government. As a practical matter, because states (including Minnesota) commonly prohibit suits to enjoin the collection of taxes, private enforcement of rights protected by the immunity doctrine most often occurs in the context of an action for a refund of the unconstitutional tax. *See, e.g., Davis and Memphis Bank.* The Minnesota Supreme Court's decision denying refunds thus eviscerates private enforcement of immunity doctrine rights.

The threat to private causes of action under the immunity doctrine is a threat to the Federal Government itself. If refunds can be denied on the specious grounds advanced by Respondents in this case, then state governments can impose discriminatory taxes with impunity. The exposure to liability for refunds acts as a check on the temptations that exist for a state to benefit itself at the Federal Government's expense. Taxpayers will rarely have an incentive to challenge discrimination if there is no possibility of a refund. Indeed, if a challenge leads to higher taxes on state obligations, as it did in Minnesota, taxpayers would be well advised to allow discrimination to persist.

The issues raised in this case are important not only to the more than 700 taxpayers seeking refunds in Minnesota, but also to the future enforcement of the intergovernmental immunity doctrine generally. This Court has yet to address the prospectivity and remedial issues that arise when a state tax violates a federal statute. There is at present a particular need for guidance in this area because of the many suits pending in state courts in which refunds have been requested under 4 U.S.C. § 111, which prohibits discriminatory state taxation of federal retirees, as construed by this

Court in the *Davis* case.[6] Accordingly, Petitioners ask that certiorari be granted to reverse the decision of the Minnesota Supreme Court in this case.

II. The Minnesota Supreme Court's Holding That Petitioners Were Estopped from Challenging the Discriminatory Tax Denies Due Process and Results in Further Discrimination Against Holders of Federal Obligations.

The Minnesota Supreme Court held that Petitioners were estopped from challenging discrimination against federal obligations under 31 U.S.C. § 742 because Petitioners did not pay a judicially imposed tax on state obligation interest that was exempt under applicable state statutes. Because persons not having claims under 31 U.S.C. § 742 did not have to pay this tax, the Minnesota Supreme Court's holding in essence sanctions court-ordered "poll" taxes on the exercise of the right to enforce a federal statute. While this Court in *McKesson* observed that a state may adopt reasonable procedural rules (payment under protest, short statutes of limitations, escrow accounts, etc.) to protect its interest in sound financial planning, 110 S. Ct. at 2254, nothing in *McKesson* permits a state to impose a "poll" tax on the right to sue. Indeed, it is difficult to conceive of a more outrageous denial of a taxpayer's due process

---

[6] *See Bass v. South Carolina*, No. 23216 (S.C. Sup. Ct. Aug. 6, 1990) (1990 S.C. LEXIS 164) (applying *Davis* prospectively only); *Bohn v. Waddell*, No. TX 89-00050 (Ariz. Bd. Tax App. Apr. 6, 1990) (1990 Ariz. Tax LEXIS 8) (awarding partial refunds only); *Tax News*, Iowa Department of Revenue (August 1990) (pending case addressing prospective application of *Davis* will affect status of 30,000 amended returns); Douglas, *State Tax and Budget Actions*, Tax Notes, July 30, 1990, p. 605 (reporting Montana trial court denial of retroactive relief in *Davis* action, with appeal to state supreme court likely); Eckl, Felde, Wolfe & Zimmerman, *State Taxation of Public Pensions: The Impact of Davis v. Michigan*, Tax Notes, May 28, 1990, pp. 1119, 1127 (*Davis* decision affected 24 states, with refund actions involving prospectivity and remedial questions pending in a number of those states).

right to "meaningful backward-looking relief to rectify any unconstitutional deprivation." *McKesson*, 110 S. Ct. at 2247.

Further, the effect of the court's holding would be to impose a requirement on persons holding federal obligations -- that they make a contribution of tax with respect to exempt income -- that is not imposed on taxpayers not holding federal obligations. As a precondition to challenging a discriminatory tax, taxpayers would have to pay an alternative form of discriminatory tax. Such discrimination itself runs afoul of 31 U.S.C. § 742 and the intergovernmental immunity doctrine.[7]

While the principal difficulties with the estoppel theory are that it denies due process and creates a discrimination against holders of federal obligations, other problems also exist. It is well settled that if constitutional protection from a tax is "denied on non-Federal grounds, it is the province of [the United States Supreme] Court to inquire whether the decision of the state court rests upon a fair or substantial basis." *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 282 (1932). The estoppel holding of the Minnesota Supreme Court is neither fair nor substantial.

First, the acceptance-of-benefits doctrine does not apply unless a claimant received a benefit from the very statute challenged as unconstitutional. *Kadrmas v. Dickinson Public Schools*, 487 U.S. 450, 457 (1988). Petitioners did not challenge the state obligation exemptions, the benefits of which they purportedly received. *See* Minn. Stat. § 474.12 (Supp. 1979) *and* Minn. Stat. § 136.32 (1978) (App. 52A-53A.) Rather, Petitioners challenged the tax on federal

---

[7] No taxpayer has ever been estopped by this Court under the Minnesota Supreme Court's theory. If the theory were valid, then the taxpayers in *Memphis Bank* and *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935), both should have been estopped. Schuylkill Trust owned "shares of Pennsylvania corporations, exempt from tax, of the value of $135,787." 296 U.S. at 117. Memphis Bank had exempt interest income of $348,348 "on an investment of between $11 and $16.5 million in obligations of the State of Tennessee and its political subdivisions." Brief for Respondent at 35, n. 5, *Memphis Bank*.

obligation interest. *See* Minn. Stat. § 290.08, Subd. 13 (1978) (App. 48A.) They received no benefit from this tax. Receipt of benefits under one provision of state law does not act as an estoppel to a challenge of a "different provision of state law."[8] *Kadrmas*, 487 U.S. at 457.

Moreover, the "benefit" purportedly accepted by Petitioners is wholly illusory. Interest rates on exempt state obligations were lower than they would otherwise have been if the obligations had been taxable. (App. 24A.) Thus, while Petitioners received a tax exemption, they also received less interest from state obligation issuers because of the subsidy the tax exemption provided. The issuers of state obligations, whose interest costs were reduced, received the benefits of the exemptions here at issue, not the holders of state obligations. The acceptance-of-benefits doctrine does not apply when a benefit is "inapparent." *Kadrmas*, 487 U.S. at 457.

Unless the decision below is reversed, other state courts can adopt the Minnesota Supreme Court's estoppel theory and avoid the mandate of *McKesson* that taxpayers are entitled to a clear and certain remedy when they have paid an unconstitutional tax. Indeed, it seems likely that revenue-hungry states will extend this estoppel theory beyond the intergovernmental immunity area to preclude, for example, legitimate challenges to discriminatory

---

[8] The instant case illustrates the unfairness of estopping a taxpayer from challenging a statute because the taxpayer received benefits under a different statute. Under the Minnesota Supreme Court's view, Petitioner Cambridge is estopped from recovering tax on $612,697 of federal obligation interest for having failed to pay tax on only $70,911 of state obligation interest. The detriment suffered by Cambridge is wholly disproportionate to the benefit allegedly received. Petitioners other than Cambridge also received significantly less state obligation interest than federal obligation interest.

taxation under the Commerce and Equal Protection Clauses.[9] The estoppel holding of the Minnesota Supreme Court thus clearly merits review, if not summary reversal, by this Court.

III. The Minnesota Supreme Court's Holding That Discrimination Could Be Cured by Imposing a Fictitious Tax on State Obligation Interest Is in Conflict with *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco* and Other Decisions of This Court.

The Minnesota Supreme Court held that it would cure discrimination against federal obligations by revoking the exemptions for state obligations and by judicially imposing a retroactive tax with respect to state obligation interest. However, the court held that this supposedly curative tax did not have to be collected. (App. 11A-12A.) This Court in *McKesson* rejected the argument that such a fictional uncollected tax was an adequate remedy for discrimination, describing a similar contention by the revenue authorities in that case as "contrived," "self-serving," and "inconsistent with the nature of the State's due process obligation." 110 S. Ct. at 2253. The Minnesota Supreme Court purported to distinguish *McKesson* because it was a Commerce Clause case in which actual collection was "necessary in order to cure the comparative economic disadvantage caused by the discriminatory

---

[9] For example, the Court in *McKesson* noted that liquor distributors in Florida might sell beverages receiving unconstitutional tax preferences as well as beverages not receiving preferences. 110 S. Ct. at 2243, n. 3. Such a distributor would be estopped from challenging the discriminatory tax under the Minnesota Supreme Court's theory. Similarly, a taxpayer challenging discriminatory assessment of property taxes, as in *Allegheny Pittsburgh Coal Co. v. County Comm'n*, 109 S. Ct. 633 (1989), would be estopped if it also owned other property receiving preferred assessment.

tax."[10] (App. 11A.) This holding is indefensible.

There is not a scintilla of a suggestion in *McKesson* that this Court's rejection of fictional taxation as a cure to discrimination was intended to be limited to Commerce Clause cases. Indeed, the Court in *McKesson* discussed at some length its earlier decision in *Montana Nat'l Bank v. Yellowstone County*, 276 U.S. 499 (1928), which involved the application of a federal statute (§ 5219 of the Revised Statutes) requiring nondiscriminatory state taxation of national banks. 110 S. Ct. at 2248-50, 2252-53. The state court in *Montana Nat'l Bank* found that the tax as applied favored state banks over national banks and construed state law to eliminate the discrimination by imposing a higher tax on state banks. However, the court refused to order the higher tax to be collected from the state banks and it refused to order refunds of the higher tax that had been collected from the national banks. The United States Supreme Court reversed:

> Plaintiff in error cannot be deprived of its legal right to recover the amount of the tax unlawfully exacted of it by the later decision which, while repudiating the construction under which the unlawful exaction was made, leaves the moneys thus exacted in the public treasury.

276 U.S. at 504-05; *see also Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931) (refund ordered where tax discriminated in violation of § 5219 of the Revised Statutes). Thus, a state's due process obligation to provide a clear and certain

---

[10] The Minnesota Supreme Court also distinguished *Allegheny Pittsburgh Coal Co. v. County Comm'n*, 109 S. Ct. 633 (1989) which rejected a hypothetical reassessment of property values as a remedy where the taxpayer's property was valued higher than other similar properties. The court dismissed *Allegheny Pittsburgh Coal* as irrelevant because it was an equal protection case. (App. 10A.)

remedy should extend to cases -- including the instant case -- where a claim of discrimination arises under a federal statute applicable to the states under the Supremacy Clause.

To be sure, there is a difference between the instant case and the cases cited above, and that difference raises an important issue needing clarification by this Court. In both *McKesson* and *Montana Nat'l Bank*, the discrimination that existed favored one class of taxpayers over another. Thus, the actual collection of an equalizing retroactive tax from the favored class of taxpayers would cure the discrimination by treating all taxpayers the same. In the instant case, by contrast, Minnesota has favored issuers of state obligations, whose interest costs were lowered by the tax exemptions (App. 24A), and it has disadvantaged the Federal Government, which incurred higher interest costs on its borrowings because of the discriminatory tax. (App. 25A.) The interest rate *benefit* to state obligation issuers and *detriment* to the Federal Government are matters of historical record and cannot now be undone by a retroactive tax. Indeed, if the State were allowed to collect the tax on state obligations, it would benefit twice from its unconstitutional act: first, by lowering interest costs for favored issuers, and second by collecting a tax from holders of state obligations who accepted lower interest rates because the obligations were tax exempt.[11]

---

[11] Although the Minnesota Supreme Court stated that it would override the parties' stipulation and order collection of the tax but for its holding that *Memphis Bank* applied prospectively only (App. 11A-12A), actual imposition of the retroactive tax would clearly violate the Due Process Clause. This Court in *McKesson* noted that "beyond some temporal point the retroactive imposition of a significant tax burden may be 'so harsh and oppressive as to transgress the constitutional limitation . . .'" 110 S. Ct. at 2252, n. 23, *quoting Welch v. Henry*, 305 U.S. 134, 147 (1938). A 1990 court-ordered imposition of a tax on state obligation interest earned in 1979 would clearly exceed the two-year period of retroactivity approved in *Welch*. It would also exceed the "short and limited periods" of retroactivity approved in *United States v. Darusmont*, 449 U.S. 292 (1981). Moreover, even if the tax could be imposed, it could not successfully be

(footnote continued on next page)

Since a retroactive tax on state obligation interest would not undo the constitutional wrong, the Minnesota Supreme Court should have affirmed the trial court's holding that the bank excise tax was void to the extent it applied to federal obligation interest. This Court in *McKesson* observed that when a tax is "beyond the State's power to impose," then the state has "no choice but to 'undo' the unlawful deprivation by refunding the tax . . .." 110 S. Ct. at 2251. *Cf. Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 752 (1961), *reh'g denied*, 366 U.S. 947 (1961) (intergovernmental immunity case in which discriminatory tax held void); *Phillips Chemical Co. v. Dumas Indep. School Dist.*, 361 U.S. 376, 387, *reh'g denied*, 362 U.S. 937 (1960) (same).

This Court has yet to address the remedial issues involved when a tax is unlawful under the intergovernmental immunity doctrine and 31 U.S.C. § 742. Petitioners respectfully ask that the Court do so in this case, and that it hold that the principles set forth in *McKesson* apply with even greater force in the intergovernmental immunity context.

IV. The Minnesota Supreme Court's Holding Applying *Memphis Bank & Trust Co. v. Garner* Prospectively Only Is in Conflict with This Court's Decisions in *American Trucking Ass'ns, Inc. v. Smith* and *Ashland Oil, Inc. v. Caryl.*

Federal law (31 U.S.C. § 742) permits a state to levy a corporate franchise tax measured by net income, including interest on federal obligations, only if the tax is nondiscriminatory. In *Memphis Bank*, the United States Supreme Court held that a

---

collected since the statute of limitations to assess tax deficiencies in Minnesota is generally 3-1/2 years from the filing of a tax return. Minn. Stat. § 290.49, Subd. 1 (1988). This period has long since expired for 1979.

Tennessee bank tax "impermissibly discriminated" because federal obligation interest was taxable while state obligation interest was exempt. Although it conceded that the 1979 Minnesota bank excise tax was discriminatory under 31 U.S.C. § 742 as construed in the 1983 *Memphis Bank* decision, the Minnesota Supreme Court held that it would apply *Memphis Bank* prospectively only. (App. 12A.) This holding is in obvious conflict with this Court's prospectivity decisions last Term. *See American Trucking Ass'ns, Inc. v. Smith*, 110 S. Ct. 2323 (1990), *and Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202 (1990).

The plurality in *American Trucking*, following *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), held that a United States Supreme Court decision cannot be given prospective-only application unless it overrules clear past precedent or otherwise announces a revolutionary change in the law. *American Trucking*, 110 S. Ct. at 2331-32; *Ashland Oil*, 110 S. Ct. at 3204-5. The Minnesota Supreme Court held that *Memphis Bank* must have significantly changed prior law because Petitioners did not bring suit until after the case was decided. (App. 13A.) The court relied upon a prior decision by the Oklahoma Supreme Court that limited *Memphis Bank* to prospective cases because "[a]lthough the new principle of law established in *Memphis Bank* might be characterized as merely a progression from former decisions, it was not foreseen by the Commission, nor by the Oklahoma Legislature." *First of McAlester Corp. v. Oklahoma Tax Comm'n*, 709 P.2d 1026, 1036 (Okla. 1985). (App. 14A.)

This reasoning is completely at odds with the prospectivity decisions of the United States Supreme Court. A decision does not establish a new principle of law if it merely extends constitutional doctrine "beyond the context in which it originated." *Ashland Oil*, 110 S. Ct. at 3205. Moreover, the issue is not whether Petitioners or Respondents were aware of the discrimination or actually foresaw the decision in *Memphis Bank*. Whether a decision should

be applied prospectively only "does not rest on the subjective interpretations of discrete, affected persons and their legal advisers." *Florida v. Long*, 487 U.S. 223, 237 (1988), *reh'g denied*, 487 U.S. 1263 (1988). The issue is an objective one: Did *Memphis Bank* "overrule clear past precedent" or "decide a wholly new issue of first impression." *Ashland Oil*, 110 S. Ct. at 3205.

The answer is no. *Memphis Bank* did not overrule a prior decision or decide a wholly new issue. The Court in *Memphis Bank* noted that it had "frequently considered" the nondiscrimination rule in its intergovernmental immunity decisions going back to *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), and that 31 U.S.C. § 742 was "principally a restatement of the constitutional rule." 459 U.S. at 396-97. The Court observed that it had squarely held in *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935), that the states may not impose taxes with respect to federal obligations that are not equally imposed with respect to obligations issued by a state or anyone else. 459 U.S. at 396-98. After review of *Schuylkill Trust* and its other nondiscrimination precedents, the Court held *unanimously* that its decision in *Memphis Bank* was "clear . . . under the principles established in our previous cases . . . ." 459 U.S. at 398.

A decision that is "clear" under principles established in earlier cases does not decide a "wholly new issue of first impression." *Cf. Ashland Oil*, 110 S. Ct. at 3205. Indeed, the nondiscrimination principle was so firmly established prior to *Memphis Bank* that in 1939 the Minnesota Supreme Court itself, in reliance upon *Schuylkill Trust*, struck down a corporate excise tax that discriminated against federal obligations. *See State v. Duluth M. & N. Ry. Co.*, 207 Minn. 618, 292 N.W. 401 (1939), *reh'g denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940). The Minnesota Supreme Court in the instant case simply refused to acknowledge the existence of *Schuylkill Trust* and *Duluth M. & N. Ry.* Because no new principle of law was announced in

Memphis Bank, the Minnesota Supreme Court had no basis upon which to apply *Memphis Bank* prospectively only.

The Minnesota Supreme Court's prospectivity holding cannot be dismissed as only a mistaken application of *Chevron Oil*. Rather, the prospectivity holding is clearly no more than a pretext designed to cover the court's blatant disregard for federal constitutional rights which, if enforced, would have a fiscal impact on the State. State courts should never be permitted to evade the consequences of United States Supreme Court decisions through wholly specious prospectivity rulings. Petitioners therefore urge that certiorari be granted and the decision below reversed.

A further, equally compelling, reason exists for granting certiorari in this case. The four dissenting justices in *American Trucking* stated that prospective application is not permissible in any case involving a substantive issue of law. In the view of the dissent, such decisions apply retroactively to all cases under adjudication. 110 S. Ct. 2355-56. Justice Scalia indicated that he would join the dissenters to form a majority in support of this position in a case -- such as the instant case -- not involving "negative" Commerce Clause jurisprudence. 110 S. Ct. at 2343-45. Justice Scalia observed: "Since the Constitution does not change from year to year; since it does not conform to our decisions, but our decisions are supposed to conform to it; the notion that our interpretation of the Constitution in a particular decision could take prospective form does not make sense." *American Trucking*, 110 S. Ct. at 2343 (Scalia, J., concurring).

Petitioners agree that it is inconsistent with the judicial function for courts to decide when interpretations of constitutional law shall go into effect. Petitioners think it equally clear that courts, when interpreting statutes, do not have the power to override a legislative determination regarding the statute's effective date. The Minnesota Supreme Court had no authority to refuse to apply

the 1959 statute's nondiscrimination rule to 1979.[12] Petitioners therefore request that the Court grant certiorari to so hold.

---

[12] The statue at issue in this case, an amendment to 31 U.S.C. § 742, was adopted and became effective on Sept. 22, 1959. Act of September 22, 1959, Pub. L. No. 86-346, § 105(a), 73 Stat. 621, 622.

CONCLUSION

For the reasons set forth above, Petitioners request that this petition for certiorari be granted.

Respectfully submitted,

Robert L. Schnell, Jr.*
Walter A. Pickhardt
Patrick J. Schiltz
FAEGRE & BENSON
2200 Norwest Center
90 South Seventh Street
Minneapolis, MN 55402-3901
Telephone: (612) 336-3000

Christopher J. Dietzen
Andrew J. Mitchell
LARKIN, HOFFMAN, DALY & LINDGREN
1500 Northwestern Financial Center
Minneapolis, MN 55431
Telephone: (612) 835-3800

Laurance R. Waldoch
James P. McCarthy
LINDQUIST & VENNUM
4200 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
Telephone: (612) 371-3211

ATTORNEYS FOR PETITIONERS

*Counsel of Record

IN SUPREME COURT

No. C0-89-2097

Ramsey County

Yetka, J.
Concurring specially, Kelley, J.

Cambridge State Bank, et al.,

Respondents,

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Filed July 20, 1990
Office of Appellate courts

Respondent,

vs.

Arthur C. Roemer, Commissioner, Department of Revenue, and the State of Minnesota,

Appellants.

SYLLABUS

1. A taxpayer who assumes the validity of a statute by invoking its provisions in order to obtain a tax benefit is estopped from attacking the statute's constitutionality.

2. Where it is clear that the legislature would have enacted a statute without the provisions which are unconstitutional, the proper procedure is to apply Minn. Stat. § 645.20 (1988) and sever the invalid provisions.

3. Pursuant to the three-part test set forth in Chevron Oil Co. v. Huson, 404 U.S. 97, 106-07 (1983), the United States

Supreme Court's decision in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), must be applied prospectively.

Affirmed in part, reversed in part.

Heard, considered and decided by the court en banc.

OPINION

YETKA, Justice.

In the autumn of 1984, respondent banks commenced a tax refund claim in the district court of Ramsey County pursuant to Minn. Stat. § 290.50, subd. 2 (1988). This consolidated action by over 170 Minnesota banks sought tax refunds for the tax years 1979 through 1983. The district court concluded that the pre-1983 Minnesota bank excise tax imposed by Minn. Stat. § 290.361 (1984) (repealed 1987) is, in substance, an income tax and discriminates against federal debt instruments in violation of the borrowing and supremacy clauses of the United States Constitution. The court found that the inclusion of interest from federal obligations in the calculation of the banks' franchise tax was discriminatory and, therefore, in violation of 31 U.S.C. § 3124(a) (1982) (formerly numbered § 742)[1] because interest from certain state obligations was exempt from the calculation of the tax. The district court ordered the State of Minnesota to refund to respondents, with interest, taxes collected under the statute between 1979 and 1983. We affirm in part and reverse in part.

The record in this case includes a detailed stipulation of facts entered into by the parties. The trial was bifurcated into two

---

[1] 31 U.S.C. §3124 (1982) provides:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except---
>
> (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation * * * .

(Emphasis added.)

phases: Phase I, a liability phase, and Phase II, a remedy phase. The issue of liability was tried before the court on November 6-17, 1986. By agreement of counsel and order of the court, evidence was presented by four banks for the 1979 tax year. The four banks were: Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The court heard lengthy and detailed testimony from several expert witnesses concerning the economic impact of the tax on the borrowing power of the federal government. The parties agreed that the conclusion of the court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States government, but did not include interest income earned by the banks on obligations of certain agencies of the State of Minnesota. Respondents filed timely protective claims for refunds for the tax year 1979 and timely filed these actions for refunds.

The trial court concluded that the tax violated 31 U.S.C. § 3124. In summary, section 3124 provides that obligations of the United States government are immune from state and local taxation, but interest earned on these obligations may be included in the measure of a "non-discriminatory" corporate franchise tax. The trial court concluded that the Minnesota tax was a discriminatory income tax and, therefore, violated the supremacy and borrowing clauses of the United States Constitution. The court's conclusion regarding discrimination was premised on a finding that, under Minnesota law, interest earned on obligations of the United States Government was included in the computation of the corporate franchise tax whereas interest earned on certain obligations[2] of the State of

---

[2] Appellants dispute the number of obligations that are exempt from the computation of the corporate franchise tax. Appellants concede, however, that at (footnote continued on next page)

Minnesota was exempt from the computation of the corporate franchise tax.

The trial court also concluded that, although the tax imposed by Minn. Stat. § 290.361 (1984) is labeled an "excise" tax, it is a direct tax on net income for purposes of federal statutory and constitutional law. The trial court rejected all of appellants' arguments and ordered that the appellants were liable for refunds in amounts to be determined in Phase II of the trial. On August 28, 1989, following phase II of the trial, the court ruled that appellants were liable for refunds, with interest, and ordered retroactive relief in the following amounts: Norwest-$189,065; Sleepy Eye-$36,278; Cambridge-$23,833; and Midway-$46,574. This appeal followed.

I. The first issue raised by this appeal is whether the bank tax imposed under section 290.361 and governed by Minn. Stat. § 290.02 (1988) is a non-discriminatory franchise tax. This court has determined that the tax imposed by section 290.02 is a franchise tax. Reuben L. Anderson-Cheme, Inc. v. Commissioner of Taxation, 303 Minn. 124, 226 N.W.2d 611, appeal dismissed, 423 U.S. 886-87 (1975) (dismissed for lack of substantial federal question). Respondents ask this court to overrule Reuben on the grounds that, in "economic effect," the tax is an income tax. According to this theory, the tax would clearly violate 31 U.S.C. § 3124 and would, therefore, be unconstitutional under the borrowing clause of the United States Constitution. The trial court accepted this theory and concluded that the tax is an income tax. We disagree.

---

least two state/municipal obligations were exempt:

(1) Industrial Development Bonds issued under Minn. Stat. ch. 474 prior to June 30, 1979; and

(2) State University Bonds issued under Minn. Stat. § § 136.31-.38;

Given that the parties have stipulated that at least some state obligations were exempt, this court need not reach the issue of whether the other types of obligations were actually exempt.

The trial court's conclusion on this issue is inconsistent with the legislative history of section 3124 and Reuben. In American Bank & Trust Co. v. Dallas County, 463 U.S. 855, 870-71, n. 13 (1983), the United States Supreme Court observed that the inability of states to include interest from federal obligations in an income tax was the primary reason for enacting tax legislation permitting the imposition on national banks of non-discriminatory franchise taxes based on corporate income. Thus, the exception for non-discriminatory franchise taxes measured by income appears to be an intentional elevation of form over substance in recognition of the fact that banks would otherwise operate totally tax free.

In Reuben, this court noted that 31 U.S.C. § 3124 was amended in 1959 so as to permit the inclusion of interest from federal obligations in the computation of a non-discriminatory franchise tax and reasoned that to conclude the tax imposed by section 290.02 was, in reality, an income tax would render the 1959 amendment "completely meaningless." See Reuben, 303 Minn. at 130, 226 N.W.2d at 615. The Reuben court's determination that the tax levied on the income from interest on government obligations is a franchise tax is supported by this court's decision in Soo Line R.R. Co. v. Commissioner of Revenue, 377 N.W.2d 453 (Minn. 1985), where the court observed that "[t]he incident of the franchise taxed under the excise tax,[3] however, is the privilege of carrying on business, not the property of the franchise." Id. at 455 (emphasis and footnote added; citation omitted). The reasoning of the Reuben court is also supported by the United States Supreme Court's observations in American Bank & Trust. Accordingly, we reverse the trial court's conclusion that the bank tax is an income

---

[3] An excise tax is a tax imposed on the performance of an act, the engaging in of an occupation, or the enjoyment of a privilege, including corporate privileges. In current usage, the term includes practically every internal revenue tax except the income tax. Black's Law Dictionary 506 (5th ed. 1979).

tax for purposes of section 3124 and conclude instead that it is a franchise tax. As a result, the next question is whether it is "non-discriminatory."

Our review of the relevant statutes convinces us that the tax in question is discriminatory. Banks doing business in the State of Minnesota during the relevant period were required to pay a tax measured by their net income. Minn. Stat. § 290.361, subd. 1. That tax was governed by the provisions of Minn. Stat. § 290.02. Id. Both Minn. Stat. § § 290.02 and 290.361 referred to an "excise" tax measured by taxable net income. Minn. Stat. § 290.08, subd. 8 (1984) (repealed 1987) exempted any interest earned on either United States or State of Minnesota obligations from gross income. That exclusion, however, was not applicable to "corporations taxable under section 290.02 or 290.361." Id. (emphasis added). Consequently, for banks doing business in the State of Minnesota, interest earned on federal obligations was included in the taxable net income figure used to compute their chapter 290 excise tax. Certain state bond enabling statues, however, overrode the above provisions of chapter 290 and exempted interest earned thereon from inclusion in income for the purpose of calculating chapter 290 taxes. See Minn. Stat. § 136.32 (1982) (amended 1983) ("SUB's"); Minn. Stat. § 474.12 (1982) (repealed 1983) (Municipal Industrial Development Bonds ("IDB's")).[4]

---

[4] The trial court also found that interest earned on obligations of the following State of Minnesota agencies was exempt from inclusion in the bank tax:

Minnesota Higher Education Coordinating Board Bonds
Minnesota Higher Education Facilities Authority Bonds
Metropolitan Transit Commission Bonds
Public Water and Sewer Bonds
Hospital District Bonds
Hospital Revenue Bonds
St. Cloud Transit Commission Bonds
Metropolitan Waste Control Commission Bonds
Housing Redevelopment Authority Bonds

(footnote continued on next page)

The trial court, in reliance on Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 398 (1983), concluded that, during the 1979 through 1983 calendar years, the bank tax was discriminatory because interest from certain State of Minnesota obligations was exempt.[5] Appellants concede that, at least as to IDB's and SUB's, the bank tax is discriminatory. Although we question the judgment of appellants in making this concession, the trial court's conclusion that the bank tax was discriminatory is affirmed as the law of this case.

II. The second issue presented by this appeal is whether the bank tax falls within a de minimis exception to section 3124. Appellants argue that the impact of the bank tax on the borrowing power of the United States government is de minimis and, therefore, the constitutional defects should be ignored. Appellants' de minimis defense is apparently based on dicta in Memphis Bank & Trust where, in a footnote, the Court stated:

> We cannot regard the impact of the discrimination as de minimis. According to the United States, which filed a brief as amicus curiae in support of reversal, if all 50 States enacted provisions comparable to the Tennessee bank tax, the United States would incur additional annual borrowing costs estimated at $280 million at an interest rate of 12%.

Id. at 398 n.8 (citation omitted).

In the present case, the trial court concluded that there is no

---

Area Redevelopment Agency Bonds
Minnesota State Armory Commission Bonds
Solid Waste Management District Bonds

[5] In 1983, the Minnesota Legislature repealed the exemption provisions contained in numerous state obligation enabling statutes. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 614-25.

de minimis defense and found that, even if there were such an exception, "[t]he economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense." We cannot say that the trial court's finding was clearly erroneous; thus, we conclude that the impact of the bank tax on federal borrowing was not de minimis. Accordingly, even assuming, arguendo, that there is a de minimis exception to section 3124, it is not applicable in the instant case.

III. Appellants argue that respondents should be estopped from asserting their claims that exemption of IDB's and SUB's from the bank tax discriminated against federal obligations under the acceptance-of-benefits doctrine. In Gale v. Commissioner of Taxation, 228 Minn. 345, 37 N.W.2d 711 (1949), the taxpayer sought to invoke the provisions of a tax statute to secure the benefit of a tax computation and, at the same time, challenged the constitutionality of another provision of the same act. Id. at 352, 37 N.W.2d at 716. This court said "[H]e who assumes the validity of a statute by invoking its provisions to obtain a tax reduction may not attack its constitutionality." Id. (citing Byard v. Commissioner of Taxation, 209 Minn. 215, 296 N.W. 10 (1941).

Respondents do not dispute that they accepted the tax benefits of the exemption for interest on State of Minnesota obligations. Instead, respondents suggest that the acceptance-of-benefits doctrine of estoppel is no longer good law. In Wegan v. Lexington, 309 N.W.2d 273, 277 (Minn. 1981), this court did not reject the acceptance-of-benefits doctrine in tax cases like Gale and Byard. See Wegan at 277. We conclude, therefore, that, under the rule in Gale, respondents should be estopped from challenging the constitutionality of the bank tax. We do not, however, decide this case on that ground alone.

IV. Based on Minn. Stat. § 645.20 (1988), appellants ask this court to declare the language in the various state obligation enabling statues which exempt the interest earned thereon from

taxation to be unconstitutional and sever it from the remaining portion of the statutes. This is a compelling argument. Minn. Stat. § 645.20 (1988) provides, in pertinent part, as follows:

> If any provision of a law is found to be unconstitutional and void, the remaining provisions of the law shall remain valid, unless the court finds the valid provisions of the law are so essentially and inseparably connected with, and so dependent upon, the void provisions that the court cannot presume the legislature would have enacted the remaining valid provisions without the void one * * * .

It is the exemption for interest earned on state obligations that makes the bank tax discriminatory and, therefore, unconstitutional. Moreover, since the legislature amended the statutes in question by deleting the challenged exemptions, this court can presume that the legislature would have enacted the remaining provisions without the void one.

Indeed, when the legislature adopted the bank franchise tax in 1941, it did not exempt the disputed state interest revenue. See Act of Feb. 21, 1941, ch. 18, § 4, 1941 Minn. Laws 23, 24. The provisions exempting interest of certain state obligations were not enacted until 1957 and 1967. Act of Apr. 24, 1957, ch. 603, § 2, 1957 Minn. Laws 753 (SUB's); Act of May 4, 1967, ch. 297, § 12, 1967 Minn. Laws 456, 465 (IDB's). Can it be said that these later additions invalidated the entire original act? We think not. Since the original act was valid, the subsequent amendments, if unconstitutional, may be severed from the original act which remains valid.

In Johnson Bros. Wholesale Liquor Co. v. Commissioner of Revenue, 402 N.W.2d 791 (Minn. 1987), this court affirmed the tax court's use of a similar remedy in addressing a discriminatory tax on wine sales. See id. at 793. The Johnson Bros. court also observed that the United States Supreme Court has recognized that a withdrawal of benefits from the favored class is an acceptable

remedy for unconstitutional discrimination. Id. (citing Iowa-Des Moines Nat'l Bank v. Bennett, 284 U.S. 239, 247 (1931). In the case at bar, the trial court simply did not apply section 645.20. Section 645.20 indicates, however, subject to certain qualifications which are not applicable in this case, that if any provision of a law is found to be unconstitutional, severance is mandatory and the remaining provisions are valid. Accordingly, this court concludes that the trial court abused its discretion in refusing to apply section 645.20 and is, therefore, reversed.

Respondents seek to avoid such a result by emphasizing that the Minnesota Department of Revenue has stipulated that it will not collect Minnesota bank taxes on interest earned from SUB's issued pursuant to Minn. Stat. § 136.31-38 or from IDB's issued prior to July 1, 1979. This stipulation arguably distinguishes the present case from Johnson Bros. wherein the Revenue Department actually collected the back taxes from the unlawfully favored wineries. See Johnson Bros. at 792.

Respondents cite Allegheny Pittsburgh Coal Co. v. County Commissioner of Webster County, 488 U.S. 336, 109 S. Ct. 633 (1989), as authority for the proposition that discriminatory taxation is not cured by raising a tax on someone else. However, they fail to point out that Allegheny was an equal protection property tax case presenting significant valuation problems and did not involve a statutory mandate such as Minn. Stat. § 645.20. Respondents also cite Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 267-81 n.7 (1984), but again fail to discuss significant differences between that case and this one. In Bacchus, the State of Hawaii imposed a 20% excise tax on wholesale liquor, but exempted certain locally manufactured alcoholic beverages. Wholesalers of nonexempt beverages challenged the tax as violative of the commerce clause. In the footnote cited by respondents, the United States Supreme Court noted that the severance issue was not presented to the Supreme Court of Hawaii in the case below and merely commented

in passing that "severance" would not relieve the harm inflicted. Bacchus, 468 U.S. at 267-68 n.7.

The recent decision in McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, ___ U.S. ___, 58 U.S.L.W. 4665 (June 4, 1990), makes clear that a state may cure the invalidity of a discriminatory tax by assessing and collecting back taxes from those who benefited from the discrimination. Id. at 4671. Although the Court concluded in McKesson that, in commerce clause cases, a state that selects this remedy must actually impose a retroactive tax, that conclusion was premised on the fact that actual collection is necessary in order to cure the comparative economic disadvantage caused by the discriminatory tax. See id. at 4671-72. The present case is distinguishable from McKesson because there is no need to remedy any comparative economic disadvantage. Accordingly, we hold that severing the invalid exemptions renders the bank excise tax non-discriminatory and thereby satisfies the due process requirement of a fully adequate post-deprivation remedy.

More fundamentally, even if actually collecting the tax is a prerequisite to curing the constitutional infirmity of the tax in question, respondents do not explain where the Revenue Department gets the authority to limit this court's power to fashion an appropriate remedy for an unconstitutional tax. See Amundson v. Cloverleaf Memorial Park Ass'n, 221 Minn. 353, 358, 22 N.W.2d 170, 172 (1946) (suggesting that mistake and lack of authority are grounds for relieving a party from a stipulation).[6] Were it not for our conclusion that the Memphis Bank case established a new principle of law that was not clearly foreshadowed, we would order the Revenue Department to assess and collect the tax attributable to the state obligation interest income. We believe that ordering actual

---

[6] When confronted with similar options, the Nebraska Supreme Court also chose to sever the unconstitutional exemptions. State ex rel. Douglas v. Karnes, 216 Neb. 750, 760, 346 N.W.2d 231, 236 (1984).

collection of the tax in this case would unfairly penalize both parties for failing to foresee the change in the law brought about in Memphis Bank. Consequently, we reject the respondents' contention that actual imposition of back taxes is necessary in this case.

An additional reason for reversing the trial court is that it inappropriately applied the Memphis decision retroactively. The three factors governing non-retroactive application of judicial decisions were set forth in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), as follows:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, it has been stressed that "we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." Finally, we have weighed the inequity imposed by retrospective application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

Id. at 106-07 (citations omitted). Applying these factors to the present case, we conclude that the decision in Memphis should be given prospective application only.

First, since the legislature passed the first state obligation interest exemption to the bank franchise tax in 1957, more that 20 years elapsed before these taxpayers questioned the validity of this exemption. Yet, respondents argue that the Memphis case should be applied retroactively because it was not, they aver, a case

deciding an issue of first impression whose resolution was not clearly foreshadowed. The fact that this case was not brought until immediately after the Memphis case was decided, however, completely eviscerates the argument that the Memphis decision was clearly foreshadowed.

Second, the primary purpose of section 3124 is to protect the borrowing power of the United States Government. See Memphis Bank, 459 U.S. at 396 (referring to the congressional intent to prevent taxes which diminish the value of United States obligations). Respondents have not explained how the borrowing power of the United States will be protected by allowing them to receive multimillion dollar refunds. It seems to us that the purpose of promoting investments in United States obligations and protecting the borrowing power of the United States Government will be just as adequately advanced by prospective application as it will by retroactive application. This is especially true given that, soon after Memphis Bank was decided, the Minnesota Legislature met and repealed the disputed exemptions for Minnesota obligations. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 613-25.

Finally, in weighing the equities involved in this case, it is obvious that retroactive application of the Memphis Bank decision would cause a hardship to the State of Minnesota. The excise taxes in question have long since been spent by the state in providing, among other things, regulatory and other public services for all taxpayers, including the respondent banks. See First Nat'l. Bank of Fredericksburg v. Commonwealth, 553 A.2d 937, 947 (Pa. 1989) (Larsen, J., dissenting). By comparison, no equivalent hardship results to the banks by a prospective application of the decision in Memphis Bank. On the contrary, respondents' taxes were actually reduced during the years the state obligation interest exemptions were mistakenly in effect. If the Memphis Bank decision is applied retroactively, respondent banks will have operated essentially tax-free during the period in question and would receive a refund of

taxes that were, in effect, paid by others. Such a result would provide respondent banks with an undeserved windfall. As corporate citizens, these banks should not be allowed to enjoy the benefits of the privilege of doing business in the State of Minnesota without paying taxes.

In construing the very same issue, the Oklahoma Supreme Court in First of McAlester Corp. v. Oklahoma Tax Commission, 709 P.2d 1026 (Okla. 1985), also decided that Memphis Bank should be applied prospectively only. The McAlester court stated:

> It is arguable that previous case law foreshadowed the Memphis Bank pronouncement. It is equally persuasive that the type of bank tax in question might reasonably have been assumed to be constitutional based on the longstanding and widespread practice of various states to which the United States Supreme Court had not specifically spoken.
>
> * * *
>
> Although the Memphis Bank case does not involve a reversal of a United States Supreme Court decision as in Texas Company, it does decide a new principle of law. * * *
>
> Although the new principle of law established in Memphis Bank might be characterized as merely a progression from former decisions, it was not foreseen by the Commission, nor by the Oklahoma Legislature.

Id. at 1034-36. We believe that the position of the Oklahoma court is sound. See also American Trucking Ass'ns, Inc. v. Smith, ___ U.S. ___, 58 U.S.L.W. 4704 (June 4, 1990) (applying the Chevron Oil test in upholding the Arkansas Supreme Court's prospective application of a United States Supreme Court decision which established a new principle of law).

For all of the above reasons, the trial court is reversed in its

finding that the Minnesota bank franchise tax is an income tax and in the remedies it imposed. Respondents' request for refunds is denied in all respects.[7]

KELLEY, Justice (concurring specially)

I concur in the result; although I do not join that part of the opinion that purports to hold that the banks should be estopped from challenging the constitutionality of the bank tax.

[7] Because of our other rulings in this case, we need not decide the issue of whether the trial court erred in refusing to reduce the ordered tax refunds by amounts allegedly allocable to the production of the interest income.

STATE OF MINNESOTA — DISTRICT COURT

COUNTY OF RAMSEY — SECOND JUDICIAL DISTRICT

---------- — CASE TYPE: OTHER CIVIL

Cambridge State Bank, et al.,

Plaintiffs,

vs. — File No. 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs. — File No. 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND ORDER ON PHASE I LIABILITY

These consolidated cases came on for trial before the Honorable Harold W. Schultz, Judge of the District Court, on October 31, November 5, 6, 7, 12, 13, 14, and 17, 1986, in Courtroom 1315, Ramsey County Courthouse, St. Paul, Minnesota.

CHRISTOPHER J. DIETZEN, ESQ., and ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

JAMES P. MC CARTHY, ESQ., and LAURENCE R. WALDOCH, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

ROBERT L. SCHNELL, JR., ESQ., of the law firm of FAEGRE & BENSON, 2300 Multifoods Tower, Minneapolis, Minnesota 55402-3694, and WALTER A PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and JAMES W. NEHER, ESQ., Special Assistant Attorney General, Second Floor, Centennial Office Building, St. Paul, Minnesota 55145, appeared representing the Defendants.

Court File No. 469151 was commenced by over 170 banks who are seeking tax refunds from the State of Minnesota for alleged over-payment of taxes in the years 1979 to 1983. Court File No. 469547 involves a similar claim on behalf of the Norwest Bank Duluth for the year 1979. The Court is informed that there are other cases pending in other jurisdictions within the State of

Minnesota involving the same issues.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of liability and damages. These Findings and Conclusions concern the liability portion of the trial.

By further agreement of counsel and order of this Court the matter was presented on a test case basis. Evidence was presented by four banks for the 1979 tax year. The four banks were: The Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The parties agreed that the conclusion of the Court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks.

Prior to the commencement of trial both parties submitted motions in limine. The plaintiffs moved for summary judgment on liability or, in the alternative, for an order to exclude certain evidence as irrelevant. The defendants moved for leave to amend their answers to assert an additional affirmative defense and for dismissal of the plaintiffs' complaints. After consideration, this Court granted the defendants' motion for leave to amend and denied all other pretrial motions. At the same time, this Court ruled that the defendants had the burden of establishing as affirmative defenses their claim with respect to the so-called issues of "comparability" and "de minimis impact."

At the inception of the trial the parties submitted a Stipulation of Facts (Plaintiffs' Exhibit 1) and attached exhibits (Plaintiffs' Exhibit 2) which were received into evidence. Based on those submissions, plaintiffs rested.

Thereafter, defendants presented their testimony on the affirmative defenses mentioned above. Defendants' witnesses were Mr. Delos Steenson and Dr. Timothy J. Nantell. Plaintiffs presented rebuttal testimony from Dr. Sung Won Sohn, Dr. John H. Kareken, and Dr. David Wyss. After defendants' rebuttal testimony

from Dr. Nantell, the trial concluded.

Having heard the testimony presented, and upon all of the evidence, files, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Order.

INITIAL FINDINGS

1. Several of the Findings of Fact that follow are summaries of facts detailed in the Stipulation of Facts. (See Plaintiffs' Exhibits 1 and 2.) All facts stipulated to in those two exhibits are explicitly found to be facts by this Court, although they will not be recited individually here in the interests of readability and brevity.

2. Each of the plaintiff banks paid taxes to the State of Minnesota for the tax year 1979 pursuant to Minn. Stat. § 290.361. (Stipulation of Facts, paragraph 1.)

3. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States Government. These obligations included U.S. Treasury Notes, U.S. Treasury Bills, U.S. Treasury Bonds, and obligations from various federal agencies including:

Federal Land Bank
Federal Home Loan Bank
Federal Farm Credit Bonds
Federal Credit Savings Bank
Farmers Home Administration Notes
World Bank Bonds
Bank for Cooperatives
Federal Home Loan Banks
Federal National Mortgage Association
Government National Mortgage Association

(Stipulation of Facts, paragraphs 3 and 5.)

4. Pursuant to statute, the measure of the tax paid by these banks did not include interest income earned by the banks on State

University Board Bonds (SUB's) and Industrial Development Bonds (IDB's) issued by municipalities in the State of Minnesota. (Stipulation of Facts, paragraph 4.)

5. Also exempted from inclusion in the measure of the state bank taxes paid by the plaintiffs was interest earned on the following obligations of agencies of the State of Minnesota:

Minnesota Higher Education Coordinating Board Bonds
Minnesota Higher Education Facilities Authority Bonds
Metropolitan Transit Commission Bonds
Public Water and Sewer Bonds
Hospital District Bonds
Hospital Revenue Bonds
St. Cloud Transit Commission Bonds
Metropolitan Waste Control Commission Bonds
Housing Redevelopment Authority Bonds
Area Redevelopment Agency Bonds
Minnesota State Armory Commission Bonds
Solid Waste Management District Bonds

6. The Plaintiffs filed timely protective claims for refunds for the tax year 1979. (Stipulation of Facts, paragraph 2.)

7. The plaintiffs in both of these consolidated actions timely filed these actions for refunds.

8. There is no economic difference between the Minnesota bank tax imposed by Minn. Stat. § 290.361, which is labelled an "excise" tax measured by net income, and a tax that is imposed directly on net income such as the federal income tax.

INITIAL CONCLUSIONS OF LAW

9. During the 1979 through 1983 calendar years, the imposition of the Minnesota bank tax, pursuant to Minn. Stat. § 290.361, on interest received or accrued from obligations of the United States and its agencies was discriminatory because interest

received or accrued from certain obligations of the State of Minnesota, its political subdivisions, and its instrumentalities was exempt from the tax. Cf. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

10. Inasmuch as the Minnesota bank tax was discriminatory during the 1979 through 1983 calendar years, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and under the Supremacy and Borrowing Clauses of the United States Constitution. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

11. The Minnesota bank tax imposed by Minn. Stat. § 290.361, although labelled an "excise" tax, is a direct tax on net income for purposes of federal statutory and constitutional law. Cf. Complete Auto Transit v. Brady, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977) (the constitutionality of a state tax depends upon its actual economic consequences, not upon the label given to it by the state).

12. Inasmuch as the Minnesota bank tax is an income tax rather than a franchise tax, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and under the Supremacy and Borrowing Clauses of the United States Constitution during the 1979 through 1983 calendar years. Cf. Federal Products Corp. v. Norberg, 429 A.2d 447 (R.I. 1981).

13. Defendants are liable to plaintiffs for refunds attributable to Minnesota bank taxes paid with respect to interest received or accrued on obligations of the United States and its agencies in amounts to be determined in a separate trials on the issue of damages.

BACKGROUND TO ADDITIONAL FINDINGS OF FACT AND CONCLUSION OF LAW

The State of Minnesota acknowledges that Minnesota's

bank tax treats interest earned on certain state obligations more favorably than it does interest earned on federal obligations. Nevertheless, the state argues that the tax is not unconstitutional. It presents three arguments in support of its position. The first is that the state obligations given preferential treatment under the state tax are not sufficiently "comparable" to federal obligations to establish discrimination. Second, the state argues that the preferential treatment of certain state obligations has little or no effect on the cost of borrowing by the federal government and, consequently, the preferential treatment is of no legal consequence. Finally, the state argues that the plaintiff banks are estopped from making these claims because they received the benefits of the provision they now claim to be unconstitutional. These defenses are referred to as the "comparability," "de minimis impact," and "estoppel" defenses.

As mentioned previously the plaintiffs moved at the inception of the trial for a ruling as a matter of law that none of these three defenses was legally cognizable. The Court denied those motions prior to trial and allowed the defendant to present testimony in support of these defenses. The Court felt that this case would be more appropriately structured for review by an appellate tribunal if these three defenses would receive a full and complete hearing. Based on all of the evidence presented by both sides, the Court makes the following additional Findings of Fact and Conclusions of Law.

ADDITIONAL FINDINGS OF FACTS CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

14. The obligations of the federal government and the exempted state obligations (See Findings 3 and 4 above) are similar in that they all are:

(a) Debt instruments (Tr. Vol. I at 48.)

(b) With fixed periods of repayment. Id.

(c) With fixed interest rates. Id. at 47

(d) With the payor of the obligation identified in the instrument. Id.

(e) With the principal amount of the debt fixed. Id.

(f) With the right in the bearer to resell them. Id. at 47.

(g) Issued by governmental agencies. Id.

(h) Issued pursuant to and in compliance with specific statutory authorization. Id.

(i) And, in the case of Federal Farm Credit Obligation and IDB's, both are used to provide low cost financing for statutorily approved purposes and both depend on repayment of debts by the beneficiary of the low cost financing. (Tr. Vol. I at 91-92.)

15. State obligations, including some IDB's, compete with some treasury obligations for investor dollars. (Tr. Vol. I at 46-47.)

16. Investors in debt instruments compare many different characteristics of those instruments in making their investment choices. (Tr. Vol. I at 46 and 48.) Among those are the characteristics of risk and liquidity. Id.

17. Obligations of the United States Treasury are generally considered to be of low risk and high liquidity. (See Defendants' Exhibit 1.)

18. Some IDB's are likewise considered to be of low risk and high liquidity. Indeed, some IDB's are perceived as being less risky and as liquid as certain of the non-treasury obligations of the federal government. (Tr. Vol. I at 63-66 and 70.)

19. Differences in risk, as well as in other characteristics, tend to be reflected in the prices of a bond. (Tr. Vol. I at 61.) The issuers of bonds which may be perceived as risky tend to offer higher interest rates than do issuers of bonds of less risk and greater

liquidity. Id. This price adjustment allows for competitive comparisons of obligations with different characteristics.

20. To the extent that the obligations of the State of Tennessee and its political subdivisions are comparable to federal obligations, Minnesota Obligations are likewise comparable. (See Plaintiffs' Exhibit 2, attachments N and P.)

B. "De Minimis Impact."

21. The exemption granted to certain state obligations under the Minnesota Bank Tax caused the interest rate for those obligations to be lower than they would have been without the exemption. [Plaintiffs' Exhibit 6, at 8 (Nantell), Tr. Vol. II at 10 (Sohn), Tr. Vol. III at 153 (Kareken).] Investors who are interested in after tax return can get a competitive return on bonds bearing lower interest if they are also granted a tax exemption on the interest earned from those bonds. [Tr. Vol. II at 14, 30-31 (Sohn), Tr. Vol. IV at 7 (Kareken), Tr. Vol. V at 37-38 (Wyss).]

22. Because the tax exemption allows these obligations to carry lower interest rates, the demand for this type of credit among borrowers was higher than it would have been without the exemption. Id.

23. This phenomenon alone increases the interest rates on certain federal obligations. [Tr. Vol. IV at 17-19 (Kareken), Tr. Vol. V at 16-18 (Wyss).]

24. Moreover, the evidence established that as a result of lower interest rates on the tax exempt bonds there was a net increase in the amount of borrowing over that which would have existed without the exemption. [Tr. Vol. II at 17 (Sohn) and, e.g., Tr. Vol. V at 31 (Wyss).] This is pictorially represented on the supply/demand curves introduced at trial. (See e.g. Plaintiffs' Exhibit 7.)

25. The net increase in borrowing caused by the tax exemptions at issue here increased the competition among all

borrowers, raising the cost to all borrowers, including the federal government. [Tr. Vol. II at 17 (Sohn), Tr. Vol. V at 33-35 (Wyss).]

26. Credible testimony established that the tax exemption under consideration here resulted in additional credit demands for IDB's of approximately thirty percent (30%) for general development bonds and up to eighty percent (80%) for pollution control and nonprofit IDB's. (See Plaintiffs' Exhibit 17 at 2-4.) On a national basis, the thirty percent (30%) additionality for industrial bonds translates to an additional $6 billion of credit demand annually. [Tr. Vol. V at 33-34 (Wyss).] The result of such an addition to the competition for credit on the federal government would be to increase federal borrowing costs approximately $1.75 billion. [Tr. Vol. V at 35 (Wyss).]

27. The preferential treatment by the state of various of its obligations burdened the holders of federal obligations. The result was that the cost of borrowing by the federal government was higher than it would have been without the preferential treatment. [Tr. Vol. II at 12 and 17 (Sohn), Tr. Vol. III at 159 (Kareken), and Tr. Vol. V at 37-44 (Wyss).]

C. "ESTOPPEL."

28. The plaintiffs, by availing themselves of the tax exemption granted by the state on certain of its obligations, did not claim any benefits under the portion of the tax code asserted by plaintiffs to have been unconstitutional.

ADDITIONAL CONCLUSIONS OF LAW CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

29. This Court concludes as a matter of law that the state obligations which received preferential treatment by the State of Minnesota are, for the purposes of the constitutional and statutory

analysis required under Memphis Bank, otherwise comparable to federal obligations.

B. "DE MINIMIS IMPACT"

30. This court further concludes that preferential treatment of state obligations is, on its face, discrimination. It would be of no legal significance had the state succeeded in establishing that the economic incident of that discrimination was minute or even nonexistent. To protect the constitutional principle at issue, it is enough that there be facial discrimination.

31. Moreover, the evidence clearly established that the discriminatory taxing scheme used by the State of Minnesota, if likewise used by all fifty states, would cause the interest rates paid by the federal government in support of its debt to rise. The economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense.

C. "The Estoppel Defense."

32. The plaintiffs are not estopped from bringing this claim for refund. The theory of estoppel upon which the defendant relies is no longer the law in the State of Minnesota. See Wegan v. Village of Lexington, 309 N.W.2d 273, 277 (Minn. 1981); Haugen v. Town of Walthen, 292 N.W.2d 373 (Minn. 1980); Werner v. Olmstead County, 290 N.W.2d 444 (Minn. 1980). Moreover, factually the theory is simply inapplicable since plaintiffs did not benefit from the provisions they claim are unconstitutional.

33. All of the foregoing Findings of Fact may, if deemed more appropriate, be considered Conclusions of Law and vice versa.

* * *

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that the defendants are adjudged liable to the plaintiffs for tax refunds in amounts to be determined in Phase II of this proceeding.

Dated at St. Paul, Minnesota, this 20th day of May, 1987.

S/Harold W. Schultz

HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT COURT

MEMORANDUM

This Court feels that an extensive memorandum quoting cases, statutes, etc., is unnecessary. The attorneys involved in this case did an exceptionally able job of preparing and presenting this case.

First of all, counsel had stipulated as to certain facts, had taken depositions, and had briefed the various issues to a point where the trial went exceptionally smooth.

Counsel presented to the Court motions which, as far as the plaintiffs were concerned, would have disposed of the case much in the manner of a summary judgment. While the arguments on the part of plaintiffs were reasonably persuasive, the Court felt that there was a danger that if the case were disposed of on that basis it could be suggested that ample opportunity to raise factual issues and defenses had not been given to the defendants. Therefore, the Court denied the motions for summary judgment and granted the defendants' motions for a hearing on the various items that defendants felt were proper defenses to plaintiffs' claims. A substantial amount of time was given to the defendants to present the testimony of experts dealing with the questions of comparability

and de minimis impact.

The argument with respect to the estoppel agreement was a legal argument not requiring any testimony.

The testimony of the expert witnesses was produced and heard by the Court in an expeditious manner. However, a complete hearing was given to the defendants with respect to these issues. Unfortunately, neither the testimony of the witnesses nor the law provide any comfort to the position taken by the defendants. This Court was convinced beyond any doubt that the plaintiffs must prevail in this matter.

A careful reading of the Supreme Court with respect to the Memphis Bank and Trust Company case leads the Court to the conclusion that the Minnesota and Tennessee situations for all practical purposes are identical. The burden of proof which the state had with respect to the comparability defense was not met and the Court has concluded that on that defense the state does not prevail.

The Court further adopts the position taken by plaintiffs that the important aspect for the Court in this matter was discrimination rather than impact. It goes without saying that the Court found discrimination and sufficient impact. The state did not establish that the effect of its discriminatory tax had only a de minimis impact.

It should be noted that counsel have suggested that the policy questions and the complexity of the issues herein dictate that this matter be reviewed by the appellate system in the State of Minnesota and possibly even in the federal courts. For that reason the Court feels that the record provides an ample basis for any appellate review.

The Court feels that it would be redundant to restate the facts as set out in the Findings of Fact, Conclusions of Law, and Order. This matter has been well tried, carefully considered, and the conclusion as stated in the Court's order is, in the opinion of the

Court, the only conclusion possible based on the facts and the law.

S/Schultz, J.

Schultz, J.

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et al.,

Plaintiffs,

vs. File No. C1 84 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs. File No. C4 84 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND ORDER ON PHASE II - REFUNDS

These consolidated cases came on for trial before The Honorable Harold W. Schultz, Judge of the District Court, on February 27 and 28, 1989, in Courtroom 1531, Ramsey County Courthouse, St. Paul, Minnesota.

ROBERT L. SCHNELL, JR., ESQ., of the law firm FAEGRE & BENSON, 2200 Norwest Center, Minneapolis, Minnesota 55402, and WALTER A. PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS L. FABEL, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and BARRY GRELLER, ESQ., Special Assistant Attorney General, Tax Litigation Division, 10 River Park Plaza, Mail Station 0600, St. Paul, Minnesota 55146, appeared representing the Defendants.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of liability and damages. In Phase I of the case, the Court held that the Minnesota bank tax (Minn. Stat. §290.361) unlawfully discriminated against Federal obligations during the period 1979 through 1983 in violation of Federal law, 31 U.S.C. §742. The Court also held that the Minnesota bank tax, although labelled an "excise" tax, was an

income tax for purposes of Federal statutory and constitutional law, and that this also made the Minnesota bank tax unlawful under 31 U.S.C. §742. The Court held that Defendants were liable to Plaintiffs for refunds in amounts to be determined at Phase II of the trial. These Findings and Conclusions concern Phase II, the refund portion of the trial.

By further agreement of counsel and order of this Court, the matter was presented on a test case basis. Evidence was presented by four banks (the "Test Banks") for the 1979 tax year. The four banks were: Cambridge State Bank ("Cambridge"), Midway National Bank of St. Paul ("Midway"), First Security State Bank of Sleepy Eye ("Sleepy Eye"), and Norwest Bank Duluth ("Norwest"). The parties agreed that the conclusion of the Court on the refund phase would be conclusive as to all tax years at issue and all of the Plaintiff banks.

Prior to the commencement of trial, the parties submitted motions in limine. The Plaintiffs moved for summary judgment on certain issues or, in the alternative, for an order to exclude certain evidence as irrelevant. The Defendants also submitted motions for summary judgment. The Court heard arguments regarding all motions on January 20, 1989.

Plaintiffs' first motion requested partial summary judgment dismissing Defendants' contention that discrimination against Federal obligations should be cured by invalidating all statutes favoring state bonds. Defendants' second motion requested summary judgment in favor of invalidating such statutes, which would result in the removal of the tax-exempt status of such bonds. At the commencement of trial, the Court granted Plaintiffs' first motion and denied Defendants' second motion. A Conclusion of Law to this effect is included below in paragraph 31. The Court held that discrimination against Federal obligations would not be cured by retroactively invalidating the tax-exempt status of state bonds because, in actual fact, such bonds were tax-exempt in 1979

and the Department of Revenue has not collected (and by stipulation will not collect) tax on such bonds. Thus, granting Defendants' second motion would, in substance and effect, uphold the unconstitutional discrimination against Federal obligations and deny Plaintiffs a remedy.

Plaintiffs' second motion requested partial summary judgment dismissing the contention of Defendants' that Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), be applied on a prospective-only basis. In the alternative, Plaintiffs' moved for the exclusion of the testimony of Mr. Oja Ena with respect to the prospectivity issue. This latter motion was denied, and Mr. Ena's testimony was received. Defendants' third motion requested summary judgment that the Memphis Bank case should be applied on a prospective-only basis. Defendants also moved in their first motion for summary judgment that the Court's ruling holding the Minnesota bank to be an income tax should be applied on a prospective-only basis. Having received the testimony of Mr. Ena on these issues, the Court hereby denies all motions on prospectivity issues, which instead will be considered upon all of the evidence received.

Plaintiffs' third motion asked for summary judgment that their interest deductions should be allowed as a matter of law pursuant to Minn. Stat. §290.09, subd. 3. Defendants filed a cross-motion for summary judgment on this issue. Plaintiffs, as an alternative, requested that the testimony of Mr. Larry D. Fredricks, a witness for Defendants, be excluded. The Court denied this latter motion and received the testimony of Mr. Fredricks. The Court also received the testimony of Plaintiffs' witnesses, Mr. Philip D. Rolle and Mr. Lloyd A. Amundson, on this issue. Inasmuch as both parties have introduced testimony on the issue of whether interest deductions should be disallowed, the Court hereby denies all motions on this issue, which will instead be considered upon all of the evidence received.

At the inception of the trial of Phase II, the parties submitted a Statement of Position and Stipulation of Facts (Phase II) and attached exhibits (Plaintiffs' Exhibit 21) which were received into evidence. Thereafter, the Plaintiffs called as witnesses Mr. Rolle and Mr. Amundson, who testified regarding the investment activities, operations and expenses of banks. Defendants called Mr. Fredricks, who testified regarding the same issues, and Mr. Ena, who testified regarding the financial impact to the State of Minnesota in the event refunds are awarded to all taxpayers who have relied on the Memphis Bank case in filing refund claims. The trial then concluded.

Having heard the testimony presented, and upon all of the evidence, files, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Orders.

FINDINGS OF FACT

1. Several of the findings of fact that follow are summaries of facts detailed in the Statement of Position and Stipulation of Facts (Phase II) dated February 27, 1989 (the "Phase II Stipulation"), and exhibits thereto (See Plaintiffs' Exhibit 21). All of the facts stipulated to in the Phase II Stipulation are explicitly found to be facts by this Court, and are incorporated by reference, although they will not be recited individually here.

2. The Test Banks paid Minnesota bank taxes for 1979 in the following amounts: Northwest, $229,295 (Phase II Stipulation, ¶ 28); Sleepy Eye, $36,378.36 (Phase II Stipulation, ¶ 33); Cambridge, $23,933 (Phase II Stipulation, ¶ 38); Midway, $293,840 (Phase II Stipulation, ¶ 43).

3. The items of income, deduction and credit reported by each Test Bank on its Minnesota bank tax return for 1979 were accurate in amount. Such items were also properly reported for Minnesota bank tax purposes, except that (a) each Test Bank

reported as taxable income interest earned on Federal obligations, which was held exempt from tax in Phase I of this case, and (b) because such interest was held to be exempt, certain deductions previously allowable became disallowable, as hereinafter described. (Phase II Stipulation, ¶'s 30, 35, 40 and 45.)

4. The Test Banks earned interest on Federal obligations in 1979 in the following amounts: Norwest, $1,599,288 (Phase II Stipulation, ¶ 30); Sleepy Eye, $348,577 (Phase II Stipulation, ¶ 35); Cambridge, $612,697 (Phase II Stipulation, ¶ 40); Midway, $393,125 (Phase II Stipulation, ¶ 45).

5. The Test Banks incurred investment operating expenses in 1979, which consisted of operating expenses associated with Test Bank investment functions insofar as they were allocable to Federal obligations. Investment operating expenses included salaries and fringe benefits paid during the 1979 taxable year to employees whose duties included investing in Federal obligations and monitoring such investments, and certain other expenses relating thereto, including: expenses for management fees, office supplies, postage, telephone, data processing and occupancy, as well as depreciation on furniture and equipment used by personnel performing the investment function. (Phase II Stipulation, ¶ 10.C.)

6. The Test Banks incurred investment operating expenses in 1979 in the following amounts: Norwest, $23,744; Sleepy Eye, $7,395; Cambridge, $12,318; and Midway, $5,009. (Phase II Stipulation, ¶ 10.D.) The Test Banks deducted such investment operating expenses in computing their respective liability for Minnesota bank tax.

7. There was a direct relationship between investment operating expenses and investment transactions. As the number of investment transactions increased or decreased, investment operating expenses increased or decreased. The reason for this is that there was a tie-in between investment operating expenses, which represent the cost of actually making investments, and investment transac-

tions. (Tr. Vol. I at 63-66 [Rolle].)

8. Investment operating expenses incurred and deducted by the Test Banks were connected with or allocable against interest earned on Federal obligations. (Phase II Stipulation, ¶ 10.B; Tr. Vol. I at 63 [Rolle]; Tr. Vol. I at 176-180 [Amundson].)

9. Banks have a legal obligation under their charters to accept deposits. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I. at 187-88 [Amundson].) Banks can indirectly affect the amount of funds deposited by customers by setting interest rates paid on deposits and by advertising. However, banks cannot control the amount of deposits. (Tr. Vol. I at 67-72 and 115 [Rolle].)

10. Banks have a legal obligation under their charters and the Community Reinvestment Act to make loans. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I at 187-188 [Amundson].) Banks can indirectly affect the demand for loans by setting interest rates charged on loans and by advertising. However, banks cannot control the demand for loans by credit-worthy borrowers. (Tr. Vol. I at 72-76 and 115-116 [Rolle].)

11. If a bank does not have sufficient demand for loans, it may attempt to discourage a customer from depositing funds by suggesting that the customer purchase a Federal obligation, which can be sold to the customer by the bank. (Tr. Vol. I at 87-88 [Rolle].)

12. If a bank has deposits in excess of loans, because of an insufficiency in loan demand, the bank may "warehouse" its excess funds. In other words, it may invest its excess funds until an opportunity to lend the funds arises. Banks sometimes "warehouse" excess funds by purchasing Federal obligations. (Tr. Vol. I at 76-79 and 116 [Rolle]; Tr. Vol. I at 191-192 [Amundson].)

13. Banks do not accept deposits for the purpose of warehousing funds. (Tr. Vol. I at 129 [Rolle]; Tr. Vol. I at 192 [Amundson].)

14. Banks sometimes use Federal obligations to provide

liquidity. (Tr. Vol. I at 138-139 [Rolle]; Tr. Vol. I at 188 [Amundson].) However, they are not obligated to use Federal obligations to provide liquidity and commonly use other kinds of securities for this purpose. (Tr. Vol. I at 139-140 [Rolle].)

15. Banks do not accept deposits for the purpose of creating liquidity through the purchase of Federal obligations. (Tr. Vol. I at 189 [Amundson].)

16. Banks sometimes use Federal obligations to meet pledging requirements if a state or local government deposits funds in excess of $100,000. (Tr. Vol. I at 189-190 [Amundson].)

17. Banks do not accept deposits requiring pledged assets for the purpose of purchasing Federal obligations. (Tr. Vol. I at 190 [Amundson].)

18. Each of the Test Banks incurred (and deducted for Minnesota bank tax purposes) cost-of-money operating expenses in 1979. Cost-of-money operating expenses included salaries and fringe benefits paid to employees engaged in the fund-providing functions of a bank (i.e., those functions by which deposits and other funds are brought into a bank), including bank tellers, employees in checking operations, and employees engaged in acquiring equity capital and funds through long-term debt. Cost-of-money operating expenses also included expenses for office supplies, postage, telephone, advertising, travel, data processing and equipment and certain other expenses, all to the extent allocable to fund-providing functions. (Phase II Stipulation, ¶ 11.A.)

19. There was no relationship between cost-of-money operating expenses of the Test Banks and interest they earned on Federal obligations. For example, cost-of-money operating expenses of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 79-83 and 116-117 [Rolle]; Tr. Vol. I at 182-

185 [Amundson].)

20. Cost-of-money operating expenses incurred and deducted by the Test Banks were not connected with or allocable against interest earned on Federal obligations. (Tr. Vol. I at 60-61 [Rolle]; Tr. Vol. I at 182 and 198 [Amundson].)

21. Each of the Test Banks incurred and deducted interest expense in 1979. (Phase II Stipulation, ¶'s 12-15.)

22. With the exception of interest paid by Norwest and Cambridge on capital notes, all interest deducted by the Test Banks was paid or accrued on short-term borrowings incurred by the Test Banks in the ordinary course of their banking business including: savings accounts, savings certificates, certificates of deposit, Federal funds purchased, repurchase agreements and Federal Reserve Bank borrowings. (Phase II Stipulation, ¶ 21.)

23. The borrowings described in paragraph 22 were incurred for the purpose of making loans. (Tr. Vol. I at 104 [Rolle]; Tr. Vol. I at 206 [Amundson].)

24. Norwest and Cambridge incurred interest expense on capital notes in 1979. The capital notes were issued for the purpose of increasing their capital and expanding their capacity to make loans. (Phase II Stipulation, ¶ 23.)

25. There was no direct connection between indebtedness incurred by a Test Bank and investments by a Test Bank in Federal obligations. (Phase II Stipulation, ¶ 24.)

26. There was no relationship between interest expense paid or accrued by the Test Banks and interest income earned by the Test Banks on Federal obligations. For example, interest expense of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 83-86 [Rolle]; Tr. Vol. I at 186 [Amundson].)

27. The Test Banks did not incur or continue any indebted-

ness for the purpose of purchasing or carrying Federal obligations. (Tr. Vol. I at 62 [Rolle]; Tr. Vol. I at 186 [Amundson].)

28. The amount of refunds payable by the State of Minnesota to all taxpayers having claims similar to the Test Banks is speculative and has not been established.

29. Projections as of November, 1988, by the Minnesota Department of Finance establish that at June 30, 1989, which is the end of the current biennium, and through June 30, 1991, which is the end of the next biennium, the State of Minnesota will have sufficient funds in reserve to pay even the highest amount of refunds that might be due to all taxpayers as a result of this case. (Phase II Stipulation, Exhibit W, pages 24-26.)

30. For all tax years at issue through June 30, 1983, the Minnesota Department of Revenue did not collect, and has stipulated that it will not collect, Minnesota Bank taxes on interest earned from State University Board Bonds issued pursuant to Minn. Stat. § 136.31-38, or from Industrial Revenue Bonds issued prior to July 1, 1979, pursuant to Chapter 474 of the Minnesota Statutes, which was claimed as exempt income. (Phase II Stipulation, ¶ 58.)

CONCLUSIONS OF LAW

31. Unlawful discrimination by the State of Minnesota against Federal obligations cannot be cured by invalidating Minnesota Statutes favoring exempt State University Board Bonds, Industrial Revenue Bonds, or other exempt bonds.

32. This Court concludes that such unlawful discrimination must be cured by striking out language from Minnesota Statutes that caused Federal obligations to be taxed. Accordingly, it is held that Subdivision 13 of Section 290.08 of Minnesota Statutes shall read as follows for the period 1979 through June 30, 1983, with the stricken language severed from the statute:

Subd. 13. Certain exemptions inapplicable to

corporations. Subdivisions 4, 5, 10 and 11 shall not apply to corporations and subdivisions 7 ~~and 8~~ shall not apply to corporations taxable under section 290.02 or under section 290.361.

33. The decision of the United States Supreme Court in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), was decided "under the principles established in [its] previous cases," as the Supreme Court stated in its opinion. 459 U.S. at 398. The Supreme Court did not establish a new principle of law in Memphis Bank.

34. Under principles set forth in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), because the Memphis Bank case did not establish a new principle of law, Memphis Bank applies retroactively to the years at issue in this case.

35. The "new principle of law" test set forth in Chevron is a threshold test. Since Memphis Bank did not establish a new principle of law, it is unnecessary to apply to second and third Chevron tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of Memphis Bank would best be served by retroactive application, and (b) retroactive application of Memphis Bank would not cause an inequitable result.

36. The Court also holds that Memphis Bank should be applied retroactively because the United States Supreme Court did not limit the effect of its decision to prospective-only application. Cf. Welyczko v. U.S. Air, Inc., 733 F.2d 239 (2d Cir.), cert. denied, 469 U.S. 1036 (1984); U.S. v. Fitzgerald, 545 F.2d 578 (7th Cir. 1976).

37. This Court's holdings in Phase I of the case that the Minnesota bank tax was discriminatory and unlawful (Findings of Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 9 and 10), for which Memphis Bank is cited as authority, are also supported and compelled by the holding of the Minnesota Supreme Court in State v. Duluth M. & N. Ry Co., 207 Minn. 618, 292

N.W. 401 (1939), reh'g denied, 292 N.W. 411 (1940), cert. denied, 311 U.S. 719 (1940).

38. This Court's holdings in Phase I of the case that the Minnesota bank tax was an income tax for purposes of federal statutory and constitutional law, and was therefore unlawful (Findings of Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 11 and 12), was foreshadowed by Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), reh'g denied, 430 U.S. 976 (1977). These holdings did not establish a new principle of law. Accordingly, under Chevron, these holdings apply retroactively to the years at issue in this case.

39. Since this Court's holdings that the Minnesota bank tax is an income tax did not establish a new principle of law, it is unnecessary to apply the second and third Chevron tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of the income tax holdings would best be served by retroactive application, and (b) retroactive application of the income tax rulings would not cause an inequitable result.

40. The Test Banks are entitled to refunds of Minnesota bank taxes for the 1979 test year.

41. In computing refunds due the Test Banks, interest earned on Federal obligations (see paragraph 4, supra) should be excluded from income. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983); State v. Duluth M. & N. Ry. Co., 207 Minn. 618, 292 N.W. 401 (1939), reh'g denied, 292 N.W. 411 (1940), cert. denied, 311 U.S. 719 (1940); 31 U.S.C. §742.

42. In computing refunds due the Test Banks, investment operating expenses deducted by the Test Banks (see paragraph 6, supra) should be added back to income. Investment operating expenses were connected with and allocable against Federal obligation interest income, and are thus disallowed as deductions pursuant to Minn. Stat. § 290.10(9).

43. Because cost-of-money operating expenses were not

connected with or allocable against interest earned on Federal obligations, the Test Banks' cost-of-money operating expense deductions are not subject to disallowance under Minn. Stat. § 290.10(9).

44. The Court agrees with the parties that interest expense is connected with or allocable against Federal obligation interest (and that an interest deduction should be disallowed) only if the interest expense is paid or accrued on indebtedness incurred or continued to purchase or carry Federal obligations. (Phase II Stipulation, ¶ 26.C.)

45. Because the Test Banks did not incur or continue indebtedness to purchase or carry Federal obligations, the Test Banks' interest expense deductions are not subject to disallowance under Minn. Stat. § 290.09, Subd. 3, or Minn. Stat. § 290.10(9). Cf. Rev. Proc. 70-20, 1970-2 Cum. Bull. 499; Rev. Rul. 61-62, 1961-2 Cum. Bull. 58; I.T. 2028, III-1 Cum. Bull. 296 (1924).

46. The Court agrees with the computations of refunds submitted by the Test Banks as set forth in Exhibits F, H, J and L to the Phase II Stipulation.

47. This matter was presented on a test-case basis. The Norwest Bank Duluth lawsuit encompassed only tax year 1979. The Cambridge State Bank lawsuit involved numerous banks and tax years 1979 through 1983. Since the parties agreed that the conclusion of the Court would be conclusive as to all tax years at issue and all of Plaintiff Test Banks, there is no just reason for delay of entry of judgment as to the tax refunds due for tax year 1979 to Cambridge, Midway and Sleepy Eye.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that Defendants are adjudged liable to the Plaintiff Test Banks for tax refunds in the following amounts: Norwest, $189,065; Sleepy Eye,

$36,278; Cambridge, $23,833; Midway, $46,574. The Court orders further that interest be paid upon these amounts as required by law.

The Court further finds that there is no just reason for delay in entry of final judgment with respect to the tax refunds for tax year 1979 for Norwest, Cambridge, Midway and Sleepy Eye. Accordingly, the Court expressly directs that judgment be entered immediately in accordance with this Order.

Dated at St. Paul, Minnesota, this _____ day of _____, 1989.

_____

HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT COURT

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et. al.,

Plaintiffs,

vs. File No. C1 84 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs. File No. C4 84 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

MEMORANDUM

Phase II of the case before the Court was well prepared and tried by all counsel. The efforts on the part of counsel who tried to dispose of the matter by settlement are to be commended. However, because the matter could not be disposed of by settlement, it was necessary for the Court to hold the hearing and to rule on the issues in Phase II of this case. Primarily, the only issue before the Court was question of damages as far as all of the Plaintiffs are concerned and it should be kept in mind that this is considered a test case in a matter of speaking and, therefore, figures for some of the other Plaintiff banks will have to be determined by counsel.

The key issue as far as the Court is concerned in this matter was whether or not the principles of law announced in the Memphis Bank case should be applied on a prospective basis or a retrospective basis. This matter was vigorously contested and the Court has determined that based on all of the law and the facts at hand, the liability against the State of Minnesota in this matter is to be applied retrospectively. It should be noted that in the Memphis State Bank case, the Supreme Court of the United States did not declare its determination as to retroactivity or prospectivity. As a matter of fact, the federal judicial system has indicated that that question is one of public policy and is to be determined by the respective states. It does appear that if the United States Supreme Court wanted this matter to be handled only prospectively, it would have declared so in its opinion. And also it was declared in the case of Solum versus Stumer, 104 Supreme Court 1338, 1341 (1984) that prospectively is only an exception to the general rule of retroactivity. Counsel have indicated that there is no clear cut precedent here in the State of Minnesota with respect to this question. The Court agrees. The only instance that counsel and Court were able to find were a similar question where a similar

question was decided by one of our neighboring states, is the matter of the case of Burlington Northern, Inc., et al versus City of Superior, Wisconsin. This was in the Court of Appeals, District Three for the State of Wisconsin. And further inquiry has determined that the Supreme Court of the State of Wisconsin has refused to review the matter, so the determination of the Court of Appeals stands.

In this case, the question of retroactivity involves taxes paid by the Plaintiffs to the City was determined in favor of the Plaintiffs.

Now that the Court has concluded that the law is to be applied retroactively, the next question to be determined was whether or not certain deductions were to take place in calculating the refund. The Court did not rule on any of the motions made with respect to the problem and allowed the testimony of two witnesses for the Plaintiffs and two witnesses for the State to assist the Court in determining this matter. After hearing the testimony of all of the witnesses, the Court has determined that the Plaintiff's position in this matter is the correct one and must stand. No further purpose would be served by going into ancillary problems or to reiterate cases that stand as foundation for the Court's Finding of Fact and Conclusions of Law.

S/Harold W. Schultz

Harold W. Schultz
Judge of the District Court

STATE OF MINNESOTA **Supreme Court**

Cambridge State Bank, et. al.,
Respondents,
Norwest Bank Duluth, National Association (formerly First National Bank of Duluth,)
Respondent,

vs.
Arthur C. Roemer, Commissioner, Department of Revenue, and the State of Minnesota,
Appellants.

JUDGMENT

C0-89-2097
Appellate Court Case No.

C184469151
Trial Court Case No.

Pursuant to an order of Court heretofore duly made and entered in this cause it is determined and adjudged that the judgment of the Court below, herein appealed from, to wit, of the District Court within and for the County of Ramsey be and the same hereby is affirmed in part, reversed in part in accordance with the opinion and that judgment be entered accordingly. A certified copy of the entry of judgment and the Court's decision is herein transmitted and made part of the remittitur.

Dated and signed: FOR THE COURT 8-28-90
Dated

Attest: Frederick K. Grittner
Clerk of the Appellate Courts

By: S/J. Kurth
Assistant Clerk

Minn. Stat. § 290.08 (1978) (Denial of exemption from Minnesota bank excise tax for interest on federal obligations).

290.08 EXEMPTIONS FROM GROSS INCOME.

Subdivision 1. In general. The following items shall not be included in gross income, provided that any item which was excluded in arriving at gross income under the provisions of section 290.01, subdivision 20, shall not be again excluded under this section.

* * * *

Subd. 8. Interest from United States. Interest upon obligations of the United States, its possessions, its agencies, or its instrumentalities, so far as immune from state taxation under federal law . . .

* * * *

Subd.13. Certain exemptions inapplicable to corporations. . . . [S]ubdivisions 7 and 8 shall not apply to corporations taxable under section 290.02 or under section 290.361.

Minn. Stat. § 290.361 (1978) (Imposition of Minnesota bank excise tax).

290.361 NATIONAL AND STATE BANKS; IMPOSITION OF EXCISE TAX, COMPUTATION, SURTAX.

Subdivision 1. Imposition of excise tax. An excise tax measured by net income is hereby imposed on national and state banks by this chapter and shall be governed by the provisions of section 290.02.

* * * *

Subd 4. The revenues derived from the excise tax on banks shall be paid into the state treasury and credited to the general fund, from which shall be paid all refunds of taxes erroneously collected from banks as certified by the commissioner.

There is hereby appropriated to the persons or banks entitled to such refunds, from the general fund, an amount sufficient to make the refunds.

Minn. Stat. § 290.50 (1982 and Supp. 1983) (Refund procedures applicable to overpayments of Minnesota bank excise tax).

290.05 OVERPAYMENTS, CLAIMS FOR REFUND OR CREDITS.

Subdivision 1. Procedure, time limit. (a) A taxpayer who has paid or from whom there has been collected an amount of tax for any year in excess of the amount legally due for that year, may file with the commissioner a claim for a refund of such excess. Except as otherwise provided in this section, no claim or refund shall be allowed or made after three and one-half years from the date prescribed for filing the return (plus any extension of time granted for filing the return, but only if filed within the extended time) or after two years from the date of overpayment, whichever period is longer, unless before the expiration of the period a claim is filed by the taxpayer. For this purpose an income tax return or amended return claiming an overpayment shall constitute a claim for refund.

* * * *

Subd. 2. Denial of claim, court proceedings. If the claim is denied in whole or in part, the commissioner shall mail an order of denial to the taxpayer in the manner prescribed in section 290.46. An appeal from this order may be taken to the Minnesota tax court in the manner prescribed in section 271.06, or the taxpayer may commence an action against the commissioner to recover the denied overpayment. Such action may be brought in the district court of the district in which lies the county of his residence or principal place of business or if an estate or trust, of the principal place of its administration, or in the district court for Ramsey county. The action in the district court shall be commenced within 18 months following the mailing of the order of denial to the taxpayer. If a claim for refund is filed by a taxpayer and no order of denial is

issued within six months of the filing, the taxpayer may commence an action in the district court as in the case of a denial, but the action shall be commenced within two years of the date that the claim for refund was filed.

Minn. Stat. § 136.32 (1978) (Exemption from Minnesota bank excise tax for interest on State University Board Bonds).

136.32 BONDS, INVESTMENTS

. . . All bonds issued under sections 136.31 to 136.38 shall be exempt from all taxation. Interest paid on such bonds shall not be included in gross income for the purpose of computing any tax imposed by or under any provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Minn. Stat. § 474.12 (Supp. 1979) (Exemption from Minnesota bank excise tax for interest on Industrial Development Bonds).

474.12 EXCLUSION OF INTEREST ON BONDS FROM GROSS INCOME.

Subdivision 1. Interest paid on bonds issued under authority of this chapter shall not be included in gross income for the purpose of computing any tax imposed by or under the provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Subd. 2. Notwithstanding subdivision 1, the interest paid on bonds issued under authority of this chapter and issued after June 30, 1979 shall be exempt only as provided under section 290.08, subdivision 7, for obligations of the issuing municipality.